## TABLE OF CONTENTS


| | Page |
|---|---|
| Opinions Below | 2 |
| Jurisdiction | 2 |
| Questions Presented | 2 |
| Statute Involved | 3 |
| Statement of the Case | 3 |
| *Commodity Value—"Fair Field Price"* | 3 |
| *Gasoline Extraction Business* | 9 |
| Argument | 13 |
| Commodity Value for Pipeline-Produced Gas | 13 |
| Gasoline Extraction Business | 21 |
| Conclusion | 29 |
| Appendix | 1a |
| Opinion Below | 1a |
| Judgment | 24a |
| Order Denying Petitions for Rehearing | 25a |
| Statute Involved | 27a |


## TABLE OF CASES


| | |
|---|---|
| *Cities Service Gas Co.* v. *Federal Power Commission*, 155 F. 2d 694, 703 | 24, 25 |
| *City of Detroit* v. *Panhandle Eastern Pipe Line Company*, 3 F.P.C. 273, 290 | 26 |
| *City of Hastings, Nebraska* v. *Federal Power Commission*, 221 F. 2d 31 | 25 |
| *Colorado Interstate Gas Company*, 95 PUR N.S. 97, *reversed*, 209 F. 2d 717, *reversed*, 348 U.S. 492 | 11 |
| *Colorado Interstate Gas Company* v. *Federal Power Commission*, 324 U.S. 581, 589, 601, 608 | 18, 21, 22, 28 |
| *Federal Power Commission* v. *Colorado Interstate Gas Company*, 348 U.S. 492, 498 | 20 |

Page

*Federal Power Commission* v. *Hope Natural Gas Company*, 320 U.S. 591, 602, 617-18, 628, 647-8, 649-50, *reversing* 134 F. 2d 287, 299, 300, 307, *reversing* 3 F.P.C. 150, 178-9 ..... 13, 14, 16, 17, 18, 19, 20, 21, 24, 25

*Federal Power Commission* v. *Natural Gas Pipeline Company*, 315 U.S. 575, 586 ..... 16, 18, 19

*Mississippi River Fuel Corp.* v. *Federal Power Commission*, 163 F. 2d 433, 437 ..... 23, 25

*Panhandle Eastern Pipe Line Company* v. *Federal Power Commission*, 324 U.S. 635, 641-2 ..... 22, 23, 25

*Panhandle Eastern Pipe Line Company* v. *Michigan Public Service Commission*, 341 U.S. 329 ..... 25

*Panhandle Eastern Pipe Line Company* v. *Public Service Commission of Indiana*, 332 U.S. 507 ..... 25

*Phillips Petroleum Co.* v. *Wisconsin*, 347 U.S. 672.... 15, 26

*State Corporation Commission of Kansas* v. *Federal Power Commission*, 206 F. 2d 690, 708, *et seq.* ..... 23, 25

*United States* v. *Pierce Auto Freight Lines*, 327 U.S. 515, 535-6 ..... 19, 20

## STATUTES

Natural Gas Act Generally ..... 2, 3, 4, 16, 17, 18, 20, 22, 23, 25, 26

Section 1(b), Natural Gas Act ..... 3, 22, 23, 25, 26

Section 2(5), Natural Gas Act ..... 3, 23

Section 4(a), Natural Gas Act ..... 3, 8

Section 5(a), Natural Gas Act ..... 3, 8

Section 19, Natural Gas Act ..... 20

Section 19(a), Natural Gas Act ..... 3

Section 19(b), Natural Gas Act ..... 2, 3, 4

28 U.S.C. Section 1254(1) ..... 2

IN THE

# Supreme Court of the United States

OCTOBER TERM, 1955

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No.

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PANHANDLE EASTERN PIPE LINE COMPANY, *Petitioner*

v.

CITY OF DETROIT, MICHIGAN, AND
COUNTY OF WAYNE, MICHIGAN, *Respondents*

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## PETITION FOR WRIT OF CERTIORARI TO THE UNITED STATES COURT OF APPEALS FOR THE DISTRICT OF COLUMBIA CIRCUIT

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*To the Honorable the Chief Justice of the United States and the Associate Justices of the Supreme Court of the United States:*

Panhandle Eastern Pipe Line Company (Panhandle), petitioner herein, respectfully prays that a writ of certiorari issue to review the judgment of the United States Court

of Appeals for the District of Columbia Circuit entered December 15, 1955, insofar as said judgment set aside and reversed Federal Power Commission Opinion No. 269 and accompanying order fixing Panhandle's rates.

## OPINIONS BELOW

The opinion of the Court of Appeals (App. 1a)* is reported at 230 F. 2d 810. The short dissenting opinion on denial of rehearing (App. 25a) is not reported. Opinion No. 269 of the Federal Power Commission (R. 501 *et seq.*)** is reported at 3 PUR 3d 396.

## JURISDICTION

The judgment of the United States Court of Appeals for the District of Columbia Circuit (App. 24a) was entered December 15, 1955. Petitioner (and also the Commission) filed a timely petition for rehearing which was denied February 28, 1956 (App. 25a).

Jurisdiction is conferred upon this Court by 28 U.S.C. Section 1254(1) and Section 19(b), Natural Gas Act, 52 Stat. 831 (1938), 15 U.S.C. Section 717r(b).

## QUESTIONS PRESENTED

(1) Whether in fixing "just and reasonable" rates under the Natural Gas Act, the Federal Power Commission may, on the basis of economic and public interest considerations, depart from the conventional rate-base method and directly value as a commodity the natural gas produced by a pipeline company, without being required as a matter of law to use the conventional rate-base method as an anchor, point of departure, or basis of comparison?

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* "App." references herein are to the Appendix to this petition.

** "R" references herein are to the pages of the Joint Appendix prepared for the use of the Court below, 9 copies of which are filed with this petition.

(1a) Whether, having found that the rates fixed by the Commission were not so high as to be unlawful, the Court below correctly required the Commission, as a matter of law, to find expressly that the increase in rates resulting from the use of a direct pricing approach was precisely the dollar equivalent of the economic and public interest factors considered by the Commission in adopting that approach?

(2) Whether the extraction and sale of gasoline from natural gas, to the extent that it is a separate business not necessary to the transportation and marketing of natural gas, is nonjurisdictional and therefore required to be segregated from the regulated business for the purpose of fixing rates?

(2a) Whether, having found that the extraction and sale of gasoline from natural gas is a separate business unnecessary to a pipeline's operation, the Commission may, by a fair method, segregate from total costs those costs properly attributable to the gasoline extraction business; or whether it is required as a matter of law to charge all the costs and credit all the revenues from gasoline extraction to the cost of transporting and selling natural gas for resale?

## STATUTE INVOLVED

Pertinent provisions of the Natural Gas Act, 52 Stat. 821 (1938), as amended, 15 U.S.C. § 717 *et seq.*, are printed in the Appendix, *infra*, pages 27a-29a. These are Sections 1(b), 2(5), 4(a), 5(a), 19(a), and 19(b).

## STATEMENT OF THE CASE

Panhandle is a "natural-gas company" under the Natural Gas Act. Its pipeline system extends from fields in Texas, Kansas, and Oklahoma to northern termini in Michigan, and it transports and sells natural gas for resale to some 49 distributing utilities and directly to numerous industries and others for their own use. Part of the gas

transported and sold is produced by Panhandle itself from its own gas reserves in the Panhandle field in Texas and in the Hugoton field in Kansas and Oklahoma. The remainder is purchased from others.

*Commodity Value—"Fair Field Price."* In 1950 Panhandle was authorized by the Federal Power Commission to enlarge its system to enable it to transport and deliver an additional 250,000 Mcf of gas a day. Because of the substantial increase in the cost of service resulting from the expansion program, Panhandle, in August, 1951, proposed that an increase in its resale rates become effective upon the commencement of deliveries from the new facilities. Following the usual suspension period and lengthy hearings, the Commission, on April 15, 1954, increased Panhandle's rates by $12,788,864 annually (R. 600). This was approximately one-half the increase requested by Panhandle.[1] Pursuant to the provisions of Section 19(b), Natural Gas Act, 15 U.S.C. § 717r(b), petitioners below, respondents here, the City of Detroit, Michigan, and the County of Wayne, Michigan, sought and obtained review of the Commission's opinion and order by the Court below.

No question was raised concerning the method of valuing Panhandle's transportation facilities; and gas purchased from others was included in Panhandle's cost of service at the prices paid for the gas. The controversy centered around the rate treatment to be accorded gas produced by Panhandle itself.[2]

Panhandle proposed that the gas it produced be accorded a separate value as a commodity rather than being treated as a part of its transportation facilities. Under this proposal, Panhandle would be permitted to recover in its cost

[1] Notwithstanding this increase, Panhandle's rates remain among the lowest in the country for comparable length pipelines. The price of gas transported to Michigan by another pipeline, for example, is in excess of 31 cents per Mcf, as compared to 26 cents for Panhandle.

[2] At the time, Panhandle was producing approximately 22 percent of the gas it sold in interstate commerce.

of service the value of the gas it produced. Such value would be measured conservatively by the weighted average of all prices being received in the same area by independent producers for gas at the wellhead in arm's-length transactions. The cost of the producing properties would be excluded from Panhandle's rate base and Panhandle would assume the costs and the risks involved in exploring for, developing, and producing natural gas, and obtain in its cost of service a commodity value for such gas. In short, Panhandle's own gas would be treated in virtually the same manner as the gas it purchased from others.

The Commission agreed with Panhandle that adherence to the conventional rate-base method with respect to gas produced by Panhandle gave "but scant attention to the economic aspects of the question or to the long-run economic consequences." The Commission found that there had been "a convincing showing that it [the old method] should be abandoned" (R. 522-3) and determined that "the time has come when the practice heretofore followed * * * should be re-examined in the light of its economic impacts and our experience with it" (R. 531-2).[3]

The Commission determined that the cost approach penalized the pipeline company by allowing it a return of practically nothing for producing gas rather than purchasing all of its supplies from others (R. 519).[4] It also noted that independent producers in the same field (sometimes

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[3] The Commission has had the problem of pipeline-produced gas under consideration for some time. See "Natural Gas Investigation (Docket No. G-580)" 1948 (the Smith-Wimberly Report), printed by the Government Printing Office in 1949. However, in its opinion, the Commission observed that:

> "* * * here for the first time we have before us in a rate case a complete record which fully sets forth the results of the two methods of gas pricing now at issue" (R. 522).

[4] Panhandle's evidence showed that based upon the cost approach, and after crediting against cost the profits derived from the sale of gasoline extracted from such gas and tax benefits, it would be allowed —1.24 cents per Mcf for the gas it produced (R. 519).

partners in the same well with Panhandle) received substantially higher, commodity value prices for identical gas (R. 534-5).

The Commission further found that the weighted average arm's-length prices of gas at the wellhead in the fields where Panhandle produced gas, established by uncontradicted evidence, provided a "conservative measure of the commodity value of the gas which Panhandle produces" (R. 521).[5]

Use of a commodity value for Panhandle's own gas, the Commission found, "yields an over-all result which is 1.3 cents per Mcf higher than a rate based on the 'cost' of its own produced gas as computed by the staff" (R. 521), *an increase to the average customer of less than 25 cents a month* (R. 522, n. 12).

Mindful of the public interest, the Commission found that for a number of reasons the treatment of natural gas as a commodity would be in the ultimate interest of the consumers who have come to rely increasingly on natural gas as a major source of their expanding energy requirements, *viz*: (1) An arbitrarily depressed price accelerates consumption and fails to encourage the discovery and development of gas, a limited and irreplaceable natural resource (R. 536-9). (2) The public interest is "definitely" advanced by natural gas production by pipeline systems themselves as distinguished from complete dependence on purchases from other producers because such production would strengthen the pipeline's bargaining position in negotiating gas purchase contracts with independent producers and would ultimately redound to the benefit of the consumers through lower gas purchase prices (R. 539). (3) By utilizing their own production to absorb seasonal and other fluctuations of consumer demand, pipelines could take their purchased gas in uniform volumes with high load factors,

[5] The weighted average wellhead prices which the Commission allowed for the gas produced by Panhandle were: (1) Oklahoma Hugoton field 11 cents per Mcf; (2) Kansas Hugoton field 9.4978 cents per Mcf; and (3) Texas Panhandle field 7 cents per Mcf.

and under the usual provisions of gas purchase contracts, this would also result in lower costs "with concomitant rate advantages" (R. 539). (4) Finally, the Commission determined that it was in the interest of consumers to actually have adequate supplies to meet their needs and that somewhat lower rates would be of no benefit if such supplies were unavailable (R. 540). Recognizing that it could not compel natural-gas companies to produce gas or explore for it, the Commission found that

> "If there is to be natural-gas exploration, development and production by pipeline systems themselves, therefore—with resultant benefits to the public interest—it follows that this must result from regulatory policies designed to encourage, rather than to penalize, such activities" (R. 540).

Disregarding the value of natural gas as a commodity had, the Commission found (R. 541), discouraged pipelines from engaging in the search for and acquisition of gas supplies of their own to the extent that no new major pipeline certificated since the rate-base approach was adopted had ever produced any significant portion of its own total supply and that the remaining pipelines were steadily decreasing the amount of gas they produced. In the case of Panhandle, this ratio has fallen from 52.4% in 1942 to 22.6% in 1952 (R. 541).

For all of the above reasons, the Commission concluded that:

> "* * * the ultimate public interest will be better served by permitting the pipeline to receive for the gas which it produces a price reflecting the weighted arm's-length payments for identical natural gas in the fields (and sometimes from the very same wells) where it is produced than through the application of the 'rate-base' method to this commodity. We find that the uncontradicted evidence introduced by Panhandle in this proceeding represents a reasonable basis for such pricing" (R. 541-2).

On review of the Commission's order, the Court of Appeals for the District of Columbia upheld the Commission's right to depart from the cost rate base method (App. 7a-9a).[6] Moreover, the Court accepted "as supported by substantial evidence the findings of the Commission regarding the weighted average arm's length prices paid at the wellhead" (App. 6a)—the commodity value. The Court also recognized that the Commission could consider economic factors in fixing pipeline rates such as the need for encouraging pipeline discovery and development of natural gas and the public interest in pipeline production of natural gas as opposed to their complete dependence for gas upon purchases from others.[7]

Nevertheless, the Court reversed the Commission on the ground that although the Commission could lawfully use a commodity value for produced gas,

> "* * * [the] conventional rate-base method * * * [must] be used as a basis of comparison. * * * Unless it is continued to be used at least as a point of departure, the whole experience under the Act is discarded and no anchor, as it were, is available by which to hold the terms 'just and reasonable' to some recognizable meaning" (App. 15a).

In addition to making the commodity value approach subservient to the use of another, inconsistent rate-making approach, the Court also superimposed a further limitation. It said that in order to permit a pipeline company a commodity value for its gas, when the rate was increased as a result, the Commission,

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[6] The Court also correctly held that the "just and reasonable" standard of Section 4(a) was not superseded by the "lowest reasonable rates" proviso of Section 5(a) (App. 9a-10a).

[7] The Court denied the Commission the right to consider, as supporting the use of a commodity value for pipeline-produced gas, either the fact that Panhandle received virtually nothing for its gas when the rate-base method was used, or the fact that the use of natural gas was accelerated by arbitrarily depressed prices. (App. 6a-7a, 11a-13a)

"* * * must see to it that the increase is in fact needed, and is no more than is needed. * * * the question is whether a lesser amount would suffice" App. 13a-14a).

Thus, the Court below unduly circumscribes, if indeed it does not foreclose, the use of an actual commodity value for natural gas by tying it to the inconsistent rate-base approach and by requiring an express finding that the difference allowed the pipeline for its gas resulting from the use of commodity value is exactly the amount required to keep the pipeline producing its own gas.

*Gasoline Extraction Business.* In addition to its natural-gas operations, Panhandle engages in the business of extracting and selling gasoline from its natural gas at a gasoline plant of its own. It also sells gasoline extracted from its natural gas at a plant of Phillips Petroleum Company (R. 544). The revenues from the sale of gasoline become involved in this rate proceeding because Panhandle's facilities are used jointly for more than one business; and thus, the Commission was called upon to determine how to treat the costs and revenues attributable or allocable to the separate gasoline extraction business. Where a business is separate from the jurisdictional business, the costs are normally eliminated from the jurisdictional cost of service and the revenues from such a business are not considered in determining the rate. Conversely in cases where the separate business has been found necessary to the jurisdictional business, its costs have been included in total jurisdictional cost of service and its revenues credited to that cost.

Previously, the Commission had found that the extraction of gasoline from the "wet" or raw gas was "necessary" to make it marketable and transportable (R. 545). Therefore, since the extraction business was then in fact essential to the business of transporting and marketing natural gas, the costs of performing the operation were charged to the consumer in the rates, and the

revenues from the sale of the by-product, gasoline, were utilized to reduce the recoverable cost of service.

In this case, however, contrary to its findings in the prior cases, the Commission determined, on the record before it, that Panhandle's extraction operation and sale of gasoline was a "separate business" (R. 545-6) which was in fact not essential to its jurisdictional business and that Panhandle would be able to discontinue the extraction of gasoline without interfering with its natural-gas business (R. 544). Consequently, there was no basis for including the costs of the extraction business in Panhandle's total cost of service, nor for crediting the extraction revenues to the jurisdictional cost of service. The Commission therefore concluded that:

> "The evidence before us would not support a similar finding [that the extraction operation was necessary to the transportation business] with respect to Panhandle's extraction operations. We conclude that, in the circumstances of the present case, Panhandle's extraction business—to the extent that such extraction is not requisite to preparation of the gas for pipeline transportation — should be treated as non-jurisdictional" (R. 546).

The changed situation resulted primarily from the fact that the proportion of raw or "wet" gas in Panhandle's pipeline system has steadily decreased through the years. More recently, blending the supplies of "wet" and "dry" gas simply produces a mixture suitable for pipeline operation without any further treatment.

In order fairly to allocate costs between jurisdictional and nonjurisdictional businesses, two methods were proposed, the one a volumetric method already in use by the Commission in the case of nonjurisdictional direct sales, the other a method based upon the loss in heating value of the gas due to the extraction process. The latter, characterized as the "Btu method" by the Commission, was found for gasoline to be "sound and appropriate in the circumstances of this case" (R. 546).

On the basis of this allocation, the Commission credited to jurisdictional cost of service almost $600,000 of the gasoline extraction revenues (R. 585-6), almost three times the amount that would have been credited if a straight volumetric method had been used.

Panhandle contended that the extraction and sale of gasoline, in the circumstances of this case at least, was not subject to the Commission's jurisdiction. Though it decided to treat the gasoline extraction business as nonjurisdictional, the Commission held it had unquestioned certificate jurisdiction over certain of the facilities which are jointly used for the purpose of the gasoline extraction operation as well as for the interstate transmission of gas (R. 545).

The Commission apparently took the position that it was required only to make certain that the jurisdictional resale customers were not charged with costs which should be borne by the extraction business and that it would not eschew jurisdiction to any greater extent. Accordingly, the Commission determined to treat as nonjurisdictional the extraction business "to the extent that such extraction is not requisite to preparation of the gas for pipeline transportation" (R. 546).

In its opinion, the Commission stated that it was of the view that the rates it prescribed for the sale of natural gas should not depend upon the "fluctuating and unregulated prices" of gasoline (R. 545). This statement was directed at other methods of allocation used in other cases before the Commission,[8] and was not the real basis for the Commission's decision.

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[8] In *Colorado Interstate Gas Company*, 95 P.U.R. N.S. 97, the Commission had already allocated costs attributable to a pipeline's gasoline extraction operations. There, it used an allocation known as the relative market value method. This method was criticized by Panhandle's witnesses on the basis of the extreme fluctuations in price of gasoline in relation to the stable price of natural gas (R. 358; 366; 373). The Commission was reversed on grounds not here material, 209 F. 2d 717, and this Court, 348 U.S. 492, again reversed. In neither instance was the Commission's power to make an allocation in circumstances such as those obtaining in this case discussed.

Stating that the fluctuating price of gasoline was the only basis for the Commission's treatment of the gasoline extraction business in this case, the Court below reversed the Commission since, the Court said, this reason was "unacceptable to the court" (App. 19a-20a).

Actually, the basis of the Court's decision was its own determination that Panhandle's "extraction process is incident to the over-all pipeline transmission and resale operations, clearly bring[ing] the extraction operations within the jurisdiction of the Commission" (App. 19a). The Court, inexplicably, failed to meet the real basis of the Commission's decision which was that that extraction of gasoline was a separate, profitable business unnecessary to the transportation and marketing of natural gas, and, accordingly, unrelated to the rates for the sale of such gas.

The Court below denied the petitions for rehearing filed by Panhandle and the Commission. Judge Danaher dissented, stating:

> "When these cases were before us I had certain misgivings. Apart from my feeling that, in principle, natural gas should be regarded as a commodity and hence a competing fuel, I am concerned about the *non-jurisdictional gasoline sales*. I think the Commission might well have convinced us that it had a proper basis for excluding the gasoline extraction credits. The petitions for rehearing have bestirred my doubts to the extent of leading me to believe that we should rehear the parties on this point * * *." (emphasis supplied) (App. 25a).

## ARGUMENT

### Commodity Value for Pipeline-Produced Gas

This is the most important rate decision to the natural-gas industry since the *Hope*[9] case. Fundamentally the case turns upon the validity of the adoption by the Commission of a direct method of pricing natural gas which is produced by a pipeline company itself.

Prior to the *Hope* case, it appeared that a regulatory agency was compelled to consider reproduction cost, price trends, etc. in determining the "fair value" of a utility's properties devoted to public service. In the *Hope* case, the Federal Power Commission boldly departed from the traditional "fair value" standard, adopting instead the prudent investment or cost rate base method of determining just and reasonable rates. This Court sustained the Commission's power to utilize the cost rate base method although, prior to that case, the method had found, in this Court, support and expression mainly in the dissents of Mr. Justice Brandeis.

In this case, another crossroads in the evolution of rate-making theory has been reached. The Commission has found that the use of original cost in relation to pipeline-produced gas militates against the public interest. In its place the Commission has now adopted a commodity value for gas produced by pipeline companies; and the fundamental issue presented to this Court is whether the Commission had the right to make such a determination.

As has happened in the past, when experience fully exposes a fallacy in the method of rate-making, a new theory supersedes it. Mr. Justice Brandeis foresaw and actively advocated the abandonment of fair value as a method of fixing rates. In the same vein, Mr. Justice Jackson in his *Hope* dissent[10] pointed to the logical-prac-

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[9] *Federal Power Commission* v. *Hope Natural Gas Company*, 320 U.S. 591.

[10] 320 U.S. at 628 *et seq.*

tical fallacies of original cost as applied to valuing natural gas and suggested the method now adopted by the Commission. In this case, as in the *Hope* case, this Court's imprimatur has become necessary before the Commission's choice of method can be fully implemented. In the *Hope* case the Court of Appeals reversed the Commission and directed it to utilize fair value as a measure of the correctness of the newer approach. Similarly, in the instant case, the Court of Appeals reversed the Commission and required it to use the traditional rate-base method as a measure of the validity of the commodity value approach.

It should be emphasized that the adoption of a commodity value for natural gas actually determines a component of the resulting rate, that is, the amount to be allowed a pipeline in its cost of service for the gas it produces and sells. Anchoring the use of a commodity value to the cost method and requiring a finding that the revenue differential between the two methods "is no more than is needed" to keep the pipeline exploring for and producing natural gas are requirements completely inconsistent with the use of a commodity value. In erecting these barriers to the use of commodity value, the Court below emasculated the new method and overlooked completely its nature and purposes. The whole purport of the Commission's decision was that pricing natural gas as a commodity was required by the public interest for all the reasons stated; and, that if gas is not so priced, pipelines will of necessity, and contrary to the public interest, discontinue producing their own gas. To compare the rate result reached by use of commodity value with what would have been reached under the cost approach is meaningless as a measure of the justness or reasonableness of the rate. The Court below held that the rates fixed by the Commission were not unreasonably high; and, if a just and reasonable result is reached by the Commission's application of a proper method, there is no need, much less legal requirement, for further testing by another method—the discarded method, at that.

The lower Court's rejection of commodity value, as a method of independent validity, as applied to pipeline-produced gas, is of transcendant importance by virtue of the wide and significant impact it may have. Shortly after the Commission's decision in this case, this Court decided the *Phillips*[11] case in which it was held that independent natural-gas producers selling to interstate pipeline companies were subject to the Commission's jurisdiction. Regulation of independent natural-gas producers who have *only* a commodity to sell involves the fixing of their rates; and it is generally conceded that it would be an insuperable task for the Commission to fix rates for such producers under the formula prescribed by the Court below. Consequently, the question of a proper method of valuing gas in the field is one of vital importance to all producers who sell in interstate commerce.[12]

The decision of the Court below also involves important questions which go to the heart of the rate-making process. As already noted, the Commission, on the basis of evidence of record and its "experience" under the rate-base approach, determined that allowance of a commodity value for pipeline-produced gas was in the public interest.

The lower Court's reaction to the Commission's adoption of the new method was to direct it to use the conventional rate-base method as a "basis of comparison," "a point of departure," or as an "anchor" for determining just and reasonable rates. The Court acknowledged that "*on this record * * * we would not consider the rates* [fixed by the Commission] *so high as to be unlawful*" (emphasis supplied) (App. 15a). Nevertheless, the Court inexplicably decided that it was necessary for the Commission to

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[11] *Phillips Petroleum Co.* v. *Wisconsin*, 347 U.S. 672.

[12] There are pending before the Commission a number of pipeline cases involving the "fair field price" for gas they produce. A decision of this case by this Court would clear the air in those cases. Moreover, innumerable producer rate cases are pending. In virtually all of these cases, the choice of a method for pricing the gas awaits the final outcome of this case.

measure the rates by the rate-base method and to show "some other justification within the periphery of the 'just and reasonable' standards" (App. 10a) before it could use commodity value, seemingly because it resulted in somewhat higher rates than would have resulted if the rate-base method had been used.

This holding of the Court below necessarily makes a sacred cow out of the "traditional" rate-base approach. A requirement that one method be measured in terms of another has no more validity now than it did when this Court decided the *Hope* case where, avoiding subservience to a fixed formula or formulae, this Court held that Congress had not provided any such formula by which a "just and reasonable" rate is to be determined and that the "end result" was the test of "just and reasonable" rates.

Thus, in addition to the manifest economic importance of the adoption of commodity value for natural-gas rate-making, the decision of the Court below conflicts with and interferes with the function of the Federal Power Commission as defined by this Court in its prior decisions.

In *Federal Power Commission* v. *Natural Gas Pipeline Company*, 315 U.S. 575, 586, the first Supreme Court case under the Natural Gas Act, this Court said:

> "The Constitution does not bind rate-making bodies to the service of any single formula or combination of formulas. *Agencies to whom this legislative power has been delegated are free, within the ambit of their statutory authority, to make the pragmatic adjustments which may be called for by particular circumstances.* * * * If the Commission's order, as applied to the facts before it and viewed in its entirety, produces no arbitrary result, our inquiry is at an end" (emphasis supplied).

Yet the decision of the Court below effectively binds the Commission to the service of the rate-base approach. Moreover, it denies the Commission any latitude in the

result that may be reached irrespective of the fact that it is the Commission's function to make "pragmatic adjustments" according to the circumstances so long as the end result reached is not arbitrary.

*Federal Power Commission* v. *Hope Natural Gas Company*, 320 U.S. 591, *reversing* 134 F. 2d 287, provides a striking parallel to this case. The lower Court then said:

> "* * * historical cost under the prudent investment theory can be adopted as the rate base without reference to other matters affecting value *only* where it can reasonably be found to represent present fair value" (emphasis supplied) (134 F. 2d at 300).

Thus, the Court then was unwilling to accept the Commission's abandonment of fair value, insisting that the Commission take into "account" the change in price levels in determining the rate base—in effect, requiring adherence to the prior fair value formula on at least a comparative basis. In that case, as here, the lower Court was at pains to disclaim invasion of the province of the Commission (134 F. 2d at 299).

Nevertheless, this Court reversed the Court of Appeals for the Fourth Circuit, stating:

> "* * * the Commission was not bound to the use of any single formula or combination of formulae in determining rates. Its rate-making function, moreover, involves the making of 'pragmatic adjustments.' * * * And when the Commission's order is challenged in the courts, the question is whether that order 'viewed in its entirety' meets the requirements of the Act. * * * Under the statutory standard of 'just and reasonable' it is the result reached not the method employed which is controlling. * * * It is not the theory but the impact of the order which counts. If the total effect of the rate order cannot be said to be unjust and unreasonable, judicial inquiry under the Act is at an end. The fact that the method employed to reach that result may contain infirmities is not then important. Moreover, the Commission's order

> does not become suspect by reason of the fact that it is challenged. It is the product of expert judgment which carries a presumption of validity. And he who would upset the rate order under the Act carries the heavy burden of making a convincing showing that it is invalid because it is unjust and unreasonable in its consequences" (320 U.S. at 602).[13]

This Court further pointed out that the Commission administered the Act and that it was not the province of the courts "to advise the Commission how to discharge its functions" (320 U.S. at 617-18).[14]

The decision of the Court below is in direct conflict with this Court's decision in the *Hope* and *Natural Gas Pipeline* cases. By denying to the Commission the power to use commodity value unless the use of that price for pipeline-produced gas is tied to the rate-base approach,

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[13] In the view of the petitioner, the Court below has, in effect, reversed the burden on review of a Commission rate order. There would seem to be no other explanation for requiring the Commission to show that it has allowed the pipeline precisely the number of dollars required to keep the pipeline in the business of producing gas. The Commission has determined here that a *commodity* value for gas is necessary for this and other reasons. In the absence of a showing that the end result of the rate order, viewed in its entirety, is arbitrary, the "heavy burden" of overturning the presumptively valid exercise of "expert judgment" has not been met.

[14] In a later decision by this Court, *Colorado Interstate Gas Company* v. *Federal Power Commission*, 324 U.S. 581, involving a claim to the fair field price of natural gas produced by a pipeline, but in the context of a proper jurisdictional allocation of the company's properties, the Court said:

> "Some have thought that to be the wiser course. But we search the Act in vain for any such mandate. * * * We do not say that the Commission lacks the authority to depart from the rate base method. We only hold that the Commission is not precluded from using it" (324 U.S. at 601).

Mr. Justice Jackson, in a concurring opinion, took this occasion to again express his views as to the propriety and economic common sense of valuing gas as a commodity.

the Court below effectively does the very thing this Court condemned in the *Hope* and *Natural Gas Pipeline* cases.

In its opinion, the Court below conceded that but for the necessity of comparing the results reached by use of the "fair field price" method, "we would not consider the rates so high as to be unlawful" (App. 15a). Consequently, the "end result" test would appear to have been met and the Court's review function was exhausted. Nevertheless, the Court below requires the Commission, if it is to use a commodity value for natural gas, to use a further test, that is, to find that any resulting increase in the rate is precisely the amount required to keep the pipeline in the business of locating, developing and producing natural gas for use in its own system.

The Court was apparently conscious of the possible inconsistency of its decision with the end result test. It said:

> "It may be thought that our reference to the rate-base method, as well as our holding that the Commission's use of the field price is invalid because not properly related to the public interest by the evidence and findings, is inconsistent with the 'end result' test employed by the Supreme Court in the *Hope* case. We think not. That test was applied in assessing the reasonableness of rates from the company's point of view" (App. 15a-16a).

Nothing in the *Hope* case suggests that the validity of a rate order depends upon the interests of the party who is seeking review. Such a doctrine would be difficult, indeed, to justify.

Ultimately, the difficulty with the decision of the Court below is that it invades and meddles with the functions of the Commission.[15] The Court erects itself the arbiter of the public interest, the protector of the consumer, whereas this Court has said in the *Hope* and *Natural Gas Pipeline* cases and elsewhere that it is the Commission's function to protect such interest. In *United States* v.

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[15] If certiorari is granted, Panhandle will also urge that, contrary to the Court below's holding, the Commission had power to

*Pierce Auto Freight Lines*, 327 U.S. 515, 535-6, for example, this Court said:

> "It is not true * * * that '* * * the courts must in a litigated case, be the arbiters of the paramount public interest.' This is rather the business of the Commission, made such by the very terms of the statute. The function of the reviewing court is much more restricted. It is limited to ascertaining whether there is warrant in the law and the facts for what the Commission has done. Unless in some specific respect there has been prejudicial departure from requirements of the law or abuse of the Commission's discretion, the reviewing court is without authority to intervene."

The realistic approach of the Commission—foreshadowed by Mr. Justice Jackson[16] in his dissent in the *Hope* case,

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look at the economic incongruities resulting from use of the cost approach for pipeline-produced gas. In addition, Panhandle will challenge the holding that the Commission could not consider accelerated usage in the context of its Opinion No. 269. Panhandle also intends to question the power of the Court below to raise *sua sponte* questions not raised by the petitioners in the Court below in petitions to the Commission for rehearing as required by Section 19, Natural Gas Act, 15 U.S.C. § 717r. Neither before the Commission nor in the Court below did anyone object to the use of the commodity value method on the grounds advanced by the Court below for setting aside the Commission's decision. See *Federal Power Commission* v. *Colorado Interstate Gas Co.*, 348 U.S. 492, 498.

[16] The prophetic words of Mr. Justice Jackson in the *Hope* case described the underlying regulatory problem as follows:

> "The service one renders to society in the gas business is measured by what he gets out of the ground, not by what he puts into it, and there is little more relation between the investment and the results than in a game of poker.
>
> * * * * *
>
> "To regulate such an enterprise by undiscriminatingly transplanting any body of rate doctrine conceived and adapted to the ordinary utility business can serve the 'public interest' as the Natural Gas Act requires, if at all, only by accident. * * * If natural gas rates are intelligently to be regulated we must fit our legal principles to the economy of

320 U.S. at 628 *et seq.*, and his concurring opinion in the *Colorado Interstate* case, 324 U.S. at 608—has, in effect, been rejected by the reluctance of the Court below to depart from the conventional cost approach. The rate-base method as a superimposed test or measure of the commodity value approach results in something which is neither fish nor fowl. As observed before, there is no workable relation between the two methods. Whether the Commission's direct method of pricing produced natural gas as a commodity can be used, or whether instead, the Court below can dictate an illogical compromise is a question which should be decided by this Court.

**Gasoline Extraction Business**

While this issue has been somewhat overshadowed by the "fair field price" question in this case, it is, in its own right, a matter of major concern to the natural gas industry.

The Commission did not completely meet Panhandle's contention that the extraction of gasoline was nonjurisdictional; but it did treat the business as nonjurisdictional and, therefore, did not credit extraction revenues to jurisdictional cost of service. It supported this treatment by a finding that the extraction operation was a separate business, unnecessary to the operation of the pipeline.

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the industry and not try to fit the industry to our books" (320 U.S. at 649-50).

Mr. Justice Jackson also posed the very question involved in this case:

> "Is it necessary to a 'reasonable' price for gas that it be *anchored* to a rate base of any kind? * * * Gas is what Hope sells and it can be directly priced more reasonably and easily and accurately than the components of a rate base can be valued. Hence the reason for resort to a round-about way of rate base price fixing does not exist in the case of gas in the field" (emphasis supplied) (320 U.S. at 647-8).

The Court below, on the other hand, held that the extraction of gasoline from natural gas by a pipeline was "within the jurisdiction of the Commission" (App. 19a), that the Commission was not entitled to allocate the costs between the two businesses and, instead, was required to use the extraction revenues to reduce the total cost of service.

The question whether the gasoline extraction business was within the jurisdiction of the Commission, where it had been found to be a separate business and not necessary to the pipeline operation, is thus squarely presented. This question has never been passed upon by this Court. In this proceeding Panhandle adhered consistently to the position that its extraction business was nonjurisdictional and that consequently, the Commission was not only entitled, but required, to allocate its costs so as to separate those which are jurisdictional from the nonjurisdictional. If Panhandle's position is correct, the Commission's decision, allocating costs, could not be overturned unless the method of allocation it used "plainly contravenes the statutory scheme of regulation." *Colorado Interstate Gas Co.* v. *Federal Power Commission*, 324 U.S. 581, 589.

In *Panhandle Eastern Pipe Line Company* v. *Federal Power Commission*, 324 U.S. 635, 641-2, this Court held that:

> "* * * *the Commission must make a separation of the regulated and unregulated business when it fixes the interstate wholesale rates of a company whose activities embrace both.* Otherwise the profits or losses, as the case may be, of the unregulated business would be assigned to the regulated business and the Commission would transgress the jurisdictional lines which Congress wrote into the Act" (citing Section 1(b) of the Act)[17] (emphasis supplied).

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[17] In the cited case this Court concluded that a formal allocation was unnecessary "under the exceptional circumstances of this case" (324 U.S. at 642).

Other courts have adhered to the principle announced by this Court in the *Panhandle* case and have held that when a pipeline uses jurisdictional facilities for a nonjurisdictional business, the Commission must allocate costs between the regulated and unregulated activities. *State Corporation Commission of Kansas* v. *Federal Power Commission*, 206 F. 2d 690, 708, *et seq.*; *Mississippi River Fuel Corp.* v. *Federal Power Commission*, 163 F. 2d 433, 437.

Therefore, where an "unregulated" or nonjurisdictional business carried on by a pipeline makes joint use of the pipeline facilities and incurs joint costs, the Commission "must" allocate costs and exclude such costs as well as the revenues of that business from those assigned to the regulated business.

Section 1(b) of the Act, 15 U.S.C. § 717(b), limits the Commission's function as to rates to determining rates and charges applicable to sales in interstate commerce of "*natural gas*" (emphasis supplied). Sales of products extracted from natural gas, like gasoline, are not sales of "natural gas." Section 2(5) of the Act, 15 U.S.C. § 717b, provides

> "'Natural gas' means either natural gas unmixed, or any mixture of natural and artificial gas."

At the time the Commission first faced the nonjurisdictional business issue raised by pipeline gasoline operations, it was generally true that the extraction of liquids from raw or "wet" natural gas had to be performed by the pipeline in order that the natural gas could be transported and marketed.[18] For this reason, the Commission then charged all costs and credited all revenues from gasoline extraction to the jurisdictional cost of service, the theory being that under those circumstances, gasoline extraction was *not* a separate business but an indispen-

[18] See cases cited by the Commission in its opinion (R. 545) and by the Court below (App. 17a).

sable part of a natural-gas company's jurisdictional business.[19]

This general approach received appellate court approval in two cases, both of which involved adjustments among affiliates. In the *Hope* case, *supra,* the question as to the treatment of revenues from extraction of gasoline came up, and the Commission credited revenues from the sale of gasoline extracted from natural gas to jurisdictional cost of service because "the extraction of gasoline * * * is necessary to make the gas marketable and transportable" (3 F.P.C. at 178-9). The Fourth Circuit affirmed (134 F. 2d at 307). This Court, on review, did not allude to that holding in any material way.

In *Cities Service Gas Co.* v. *Federal Power Commission,* 155 F. 2d 694, 703, the problem of natural gasoline operations of the Cities Service Oil Company was discussed. The Court said:

> "*If* the extraction process is *in reality* an *essential part* of the business of transporting and marketing the natural gas, the Commission was justified in ignoring the contract between the two affiliates for the purpose of determining just and reasonable rates" (emphasis supplied).

In the instant case, however, the Commission found on the record before it that precisely the opposite situation existed and that the extraction process was not "necessary" to Panhandle's transportation and marketing of the natural gas; in fact, Panhandle could, without interfering with its pipeline operation, discontinue the gasoline operation. The extraction and sale of gasoline by Panhandle were recognized as a separate business making joint use of a portion of the facilities over which the Commission has jurisdiction. Consequently, the Commission

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[19] The Commission has never assumed jurisdiction over gasoline extraction or direct sales *per se.*

held that "Panhandle's extraction business * * * should be treated as non-jurisdictional" (R. 546), and that an allocation of costs was, therefore, necessary.

Prior to the decision of the Court below, it had never been decided or even intimated that the Commission has direct jurisdiction over a pipeline's gasoline extraction operations. No such holding can be found in either the *Hope* or the *Cities Service* cases, *supra*, for in each case approval of the Commission's handling of the issue was predicated on the critical factual finding, not present in this case, that extraction was necessary to the pipeline operation.

The language of Section 1(b) of the Act defining the Commission's jurisdiction would appear dispositive of the question. A parallel problem existed at one time in the case of direct sales, that is, sales of natural gas not for "resale." Section 1(b) of the Act limits the Commission's jurisdiction as to both the commodity sold ("natural gas") and the nature of the transaction (sales for "resale"). This Court and a number of lower courts have held direct sales to be not subject to the Commission's jurisdiction even though the gas is transported through jurisdictional facilities.[20]

The Commission regularly allocates costs in the direct sale situation. In fact, in this very case, the costs attributable to direct sales were excluded from the jurisdictional cost of service and the revenues from such sales were not credited to the cost of service (R. 588 *et seq.*). While there is no basis for distinguishing between the

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[20] *Panhandle Eastern Pipe Line Company* v. *Michigan Public Service Commission*, 341 U.S. 329; *Panhandle Eastern Pipe Line Company* v. *Public Service Commission of Indiana*, 332 U.S. 507; Cf. *City of Hastings, Nebraska* v. *Federal Power Commission*, 221 F. 2d 31. Consequently, a jurisdictional allocation is required. *Panhandle Eastern Pipe Line Company* v. *Federal Power Commission, supra; Mississippi River Fuel Corp.* v. *Federal Power Commission, supra; State Corporation Commission of Kansas* v. *Federal Power Commission, supra.*

direct sale and gasoline extraction situations,[21] the Court below held the latter operation to be a jurisdictional business without regard to the fact that it was found by the Commission to be a separate business not necessary to the pipeline operations.

Panhandle has been unable, satisfactorily, to synthesize the Court's approach to the gasoline issue with that of the Commission. It is not so much a matter of a disagreement between the two as it is a reversal by the Court below on a ground not really the basis of the Commission's decision.

While the Commission treated the gasoline extraction business as nonjurisdictional, it declined to base its decision to do so on an unqualified jurisdictional basis because it had unquestioned jurisdiction over the pipeline facilities. The Commission proceeded on the theory that under the facts there was no reason either to charge jurisdictional customers with the costs of such an operation or to credit the revenues (and frequently a loss is incurred) to jurisdictional cost of service. An allocation based upon the loss in heating value of the gas as a result of the gasoline extraction was found to be "sound and appropriate" (R. 546).

This aspect of this case, like the "fair field price" issue, involves the question of the proper province of a court in reviewing a rate order of the Federal Power Commission. As to this issue, the Court below required the Commission to adhere to its conception of the Commission's "prior decisions" (App. 17a).

The Commission decided in this case to allocate Panhandle's costs so as to eliminate gasoline extraction operations as a credit or debit to jurisdictional cost of service. Broadly stated, this issue is whether the Commission is free to adopt a fair and reasonable method of cost allocation without being tied to a prior practice of

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[21] The limitation of Section 1(b) applies to each business; and in fact these operations have been held to be "comparable." *City of Detroit* v. *Panhandle Eastern Pipe Line Company*, 3 F.P.C. 273, 290.

non-allocation predicated upon an entirely different factual situation from that which now obtains. More narrowly, is the Commission not still free, under the facts of this case, to treat such a business as a separate business irrespective of the jurisdictional issue?

If gasoline extraction is unnecessary to the pipeline operation, the Commission should be free to adopt a fair allocation of costs between the necessary and unnecessary operations, for there is no basis for doing otherwise.

Whether or not gasoline extraction contributed something to the efficiency of the pipeline operation, a reviewing court cannot, in the absence of arbitrary action or an unreasonable end result, properly disturb the Commission's attempt to allocate the costs and revenues attributable to that business "*to the extent that such extraction is not requisite to preparation of the gas for pipeline transportation*" (emphasis supplied) (R. 546). The Commission having determined that the "Btu method" of allocation was "sound and appropriate" (R. 546) for such purpose, the only question for the reviewing Court was to determine whether the method "plainly contravenes the statutory scheme of regulation." *Colorado Interstate* case, 324 U.S. at 589. There was no such contention in this case and no such finding by the Court below.

In the final analysis, the Commission's treatment of the gasoline extraction operation in this case is one of those "pragmatic adjustments" clearly sanctioned by this Court and founded in law and reason.

The importance of this whole problem is underscored by Judge Danaher's dissent on rehearing (App. 25a) in which he expressed concern over the Court's decision as to "non-jurisdictional gasoline sales." Moreover, the decision of the Court below, if followed literally, has wide implications. For example, it would seem that if the gasoline extraction operation is jurisdictional, as the Court stated without qualification, then logically the Commission would fix the rates at which gasoline sales are made and in gen-

eral subject the business to the manifold regulatory controls now reserved by statute only for the natural-gas business. Moreover, it is common knowledge that many wells produce both oil and natural gas and that gasoline is extracted from both oil and gas. Making oil and gasoline operations bear their fair share of joint costs is one thing. Requiring all the revenues from these nonjurisdictional operations to be credited in their entirety to the cost of service of the jurisdictional operations is quite another.

In view of the known fact that many producers now perform their extraction operations before delivery of the "dry" or residue gas to the pipeline company, the number of natural gas companies interested in an early resolution of this important question is multiplied many times by the decision of this Court in the *Phillips* case. Because this is an important development under the Natural Gas Act, with wide horizons, and because the guidance of a decision by this Court is urgently needed to clarify the status of the gasoline extraction business, a writ of certiorari should be granted.

## CONCLUSION

For the foregoing reasons, Panhandle prays that a writ of certiorari be issued to the United States Court of Appeals for the District of Columbia Circuit to review its judgment herein.

Respectfully submitted,

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May 21, 1956

## APPENDIX

UNITED STATES COURT OF APPEALS
FOR THE DISTRICT OF COLUMBIA CIRCUIT

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No. 12351

CITY OF DETROIT, MICHIGAN, A MUNICIPAL CORPORATION, PETITIONER

v.

FEDERAL POWER COMMISSION, RESPONDENT
PANHANDLE EASTERN PIPE LINE COMPANY, INTERVENOR

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No. 12359

COUNTY OF WAYNE, MICHIGAN, A MUNICIPAL CORPORATION AND BODY POLITIC, PETITIONER

v.

FEDERAL POWER COMMISSION, RESPONDENT
PANHANDLE EASTERN PIPE LINE COMPANY, INTERVENOR

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On Petitions for Review of Order of the
Federal Power Commission

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Decided December 15, 1955

*Mr. Charles S. Rhyne*, with whom *Messrs. James H. Lee*, Assistant Corporation Counsel, Public Utilities, City of Detroit, *Eugene F. Mullin, Jr.*, and *J. Parker Connor* were on the brief, for petitioner in No. 12351.

*Mr. Leonard Simons*, of the bar of the Supreme Court of Michigan, *pro hac vice*, by special leave of Court, with whom *Mr. Harry A. Bowen* was on the brief, for petitioner in No. 12359.

*Mr. Willard W. Gatchell*, General Counsel, Federal Power Commission, and *Mr. Jacob Goldberg*, Attorney, Federal Power Commission, of the bar of the Supreme Judicial Court of Massachusetts, *pro hac vice*, by special leave of Court, with whom *Mr. Lambert McAllister*, Assistant General Counsel, Federal Power Commission, was on the brief, for respondent in both cases.

*Messrs. William E. Miller* and *Harry S. Littman* for intervenor in both cases. *Mr. Raymond N. Shibley* also entered an appearance for intervenor in both cases.

Before FAHY, DANAHER and BASTIAN, Circuit Judges.

FAHY, *Circuit Judge*: The City of Detroit, in No. 12351, and the County of Wayne, Michigan, in No. 12359, petition us to review and set aside orders of the Federal Power Commission issued April 15, 1954, and June 7, 1954.[1] Panhandle Eastern Pipe Line Company is an intervenor in both cases. This court consolidated the two cases by an order of October 1, 1954. The Commission's order of April 15, 1954, prescribed, effective May 1, 1954, certain rates and charges for the sale by Panhandle Eastern Pipe Line Company of natural gas in interstate commerce for resale. The order of June 7, 1954, denied a rehearing. The Commission found the rates and charges prescribed to be "just and reasonable" within the meaning of section 4(a) of the Natural Gas Act, 52 Stat. 822 (1938), 15 U.S.C. § 717c(a) (1952). Panhandle is a "natural-gas company," that is, it is engaged in the transportation of natural gas in interstate commerce and in its sale in such commerce for resale. Its rates and charges accordingly are within the jurisdiction of the Commission, and of this court on review of the Commission's order. See note 1 *supra*, and section 2(6) of the Natural Gas Act, 52 Stat. 822 (1938), 15 U.S.C. § 717a(6) (1952).

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[1] The review petitions are filed in this court under § 19(b) of the Natural Gas Act, 52 Stat. 831 (1938), 15 U. S. C. § 717r(b) (1952).

The Commission determined the rates and charges in the following circumstances: Pursuant to section 5(a) of the Act it ordered an investigation of Panhandle's rates. Pursuant to section 4 Panhandle subsequently filed a revised tariff proposing increased rates aggregating approximately $21,400,000. The Commission suspended this proposed increase, but later permitted it to become effective as of February 20, 1952, under a bond furnished in compliance with section 4(e). Upon conclusion of hearings on the tariff and related matters the Commission on April 15, 1954 issued its order now under review. It prescribed rates which permit an increase, effective May 1, 1954, of approximately $12,780,000 instead of the $21,400,000 sought by Panhandle. The order also directed that the record be reopened for the limited purpose of introducing evidence on the basis of which the Commission could calculate the precise amount collected by Panhandle under bond since February 20, 1952, in excess of the sum found by the Commission to be "just and reasonable." The order indicated that this sum, when determined, will have to be refunded by Panhandle with 6 per cent interest.

Panhandle owns and operates a natural gas pipeline through which it transports gas from Texas, Oklahoma, and Kansas to Michigan and intervening states. It purchases gas in the field and from other sources, including its own subsidiary, the Trunkline Gas Supply Company, and it also produces gas in the Panhandle-Hugoton gas fields in Texas, Oklahoma and Kansas. For the year 1952, the test year used by the Commission, 22.6 per cent of its total gas supply came from its own production; 25.3 per cent was purchased from Trunkline, its subsidiary; and the balance, 52.1 per cent, was purchased from others. The jurisdictional sales, that is, sales in interstate commerce for resale, amounted to 275,052,339 Mcf out of a total sales volume of 327,530,405 Mcf. Panhandle's own production, or 22.6 per cent of its total supply, amounted during the test year to 73,204,677 Mcf.

Both petitioners assert that the Commission erred (1) in allowing Panhandle the so-called "field price" or "commodity value" for its own produced gas; (2) in not considering profits from Panhandle's gasoline extraction operations when computing the revenues to be recovered by the rates; (3) in denying petitioners' motions to reopen the hearing in order to consider newly discovered evidence. In addition, petitioner City of Detroit urges (4) that the Commission erred in its treatment of accelerated amortization.[2]

We first consider whether the rates approved are "just and reasonable"[3] notwithstanding the Commission used the "field price" method with respect to Panhandle's own produced gas. In *Federal Power Commission* v. *Hope Natural Gas Co.*, 320 U.S. 591, the Supreme Court approved use of the "prudent investment" rate-base method for establishing rates to be charged by natural gas companies. Since then, until the instant case, the Commission has consistently employed this rate-base method, under which rates are considered "just and reasonable" if they will return to the company a certain percentage of profit on its rate base. The rate base is a figure representing the money prudently invested in the properties and equipment utilized in the company's transmission and production business. The percentage of profit prescribed by the Commission depends upon a variety of factors, such as

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[2] Commissioner Draper dissented from the Commission's use of the "field price" formula, the exclusion of the profits of the gasoline extraction plants, and the denial of the motions to reopen; and Commissioner Doty dissented from the Commission's treatment of the amortization question.

[3] "All rates and charges made, demanded, or received by any natural-gas company for or in connection with the transportation or sale of natural gas subject to the jurisdiction of the Commission, and all rules and regulations affecting or pertaining to such rates or charges, shall be just and reasonable, and any such rate or charge that is not just and reasonable is declared to be unlawful." Natural Gas Act § 4(a), 52 Stat. 822 (1938), 15 U.S.C. § 717c(a) (1952).

the risks of the business, the necessity for attracting capital, and the desirability of lower cost of gas to the public. In order to return a profit on the rate base the rates are set high enough to recover all costs of service, including taxes, depreciation, depletion, and all operating expenses chargeable to production and transmission.

In the instant case the Commission substantially modified this traditional rate-base approach by using a different formula for Panhandle's own producing properties. It computed a "field price" for the gas obtained from this source, based upon the "weighted average arm's length prices" established by federally unregulated bargaining for similar gas in the fields.[4] It then multiplied the volume of Panhandle's production by that "field price" and included the result in Panhandle's operating expenses as an amount to be recovered through the rates.[5] At the same time the Commission excluded from the rate base the cost of the properties which produce this gas and excluded from recoverable operating expenses the cost of producing it. The Commission states that its purpose is to allow Panhandle to receive for its own produced gas "a price reflecting the weighted average arm's-length payments for identical natural gas in the fields (and sometimes from the very same wells) where it is produced," instead of a return on its legitimate investment in the properties and equipment used in producing this gas. The Commission points out that the price or value allowed is below the rates of royalties which Panhandle was currently paying on its own production to its lessors, below the prices at which more recent gas purchase contracts have been negotiated in the Hugoton field in Texas and Kansas, and also below the reported recent range of prices in the Panhandle field of Texas and in the Gulf

[4] The prices found were 7 cents per Mcf in the Panhandle field in Texas, 9.4978 cents in the Hugoton field in Kansas, and 11 cents in the Hugoton field in Oklahoma.

[5] The total amount allowed for this gas was $5,476,804.

Coast area. It terms the amount allowed "a conservative measure of the commodity value of the gas which Panhandle produces." The Commission specifies certain adjustments which bring to $3,571,448 the total difference, applicable to jurisdictional sales, between the amount allowed by the method it adopted and that which would have been allowed by entire use of the traditional rate-base method. This amounts to an over-all increase of 1.3 cents per Mcf.

The Commission fixed a rate base of $148,609,012 for Panhandle's other properties. The accuracy of this amount is uncontested. And the 5.75 per cent rate of return fixed by the Commission on this rate base is also uncontested.[6] Furthermore, we accept as supported by substantial evidence the findings of the Commission regarding the weighted average arm's length prices paid at the wellhead. In the end, therefore, the question is whether the larger amount required to be paid by con-

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[6] Were the rate-base method applied to Panhandle's own producing properties in the case at hand, the Commission, vigorously disputed by petitioners, says that according to Panhandle's contention, "and its evidence is not contradicted by any facts on this record," the investors would be allowed "less than nothing at the well-head for each Mcf of the natural gas which it [Panhandle] produces in the Southwest. At the well-head the staff shows total Cost of Service of $3,399,165, Operating Expenses of $1,957,817, Depreciation, Depletion and Amortization totaling $548,263, and Taxes of $269,799, or total Operating Revenue Deductions of $2,775,879, and a return of $623,286, or .85 cents per Mcf. With the elimination of the tax benefit on account of the depletion allowance, amounting to $537,524, deleted by the staff, however, the net return is reduced to $85,762, or .12 cents per Mcf. And, with the further deduction of $993,306 for Extraction or Production Credits proposed by the staff, this figure is converted into a deficit of $907,544, or *minus* 1.24 cents per Mcf. Thus, on this basis it might be said that, rather than earning a fair return on its production properties, Panhandle would incur a penalty for owning and operating them. This penalty would tend to increase with the passage of time as its reserves for depreciation and depletion are built up or if its net revenues from the extraction of hydrocarbons should rise."

sumers, $3,571,448 as found by the Commission,[7] than would be charged were the rate-base method followed throughout, removes the prescribed rates from a "just and reasonable" category. If so, they are unlawful under section 4(a).

Petitioners would have us answer this question affirmatively on the ground that only a traditional rate-base method can lead to "just and reasonable" rates, or, in any event, on the ground that the field price method cannot do so. We think this position is not supported by either the statute or the decisions of the Supreme Court. It is true that in *Federal Power Commission* v. *Hope Natural Gas Co., supra*, the Court spoke in a context which might be thought to presuppose the use of some rate-base method, with latitude only within the limitations of such a method. Thus, petitioners cite the portion of the *Hope* opinion where the Court, in denying the Commission power to set rates so as to discourage industrial use of gas and encourage its domestic use, said that section 4(a) and section 5(a) "contain only the conventional standards of rate-making for natural gas companies." 320 U.S. at 616. But we think this statement, considered in light of the decision made and the specific problem to which the Court was addressing itself, does not mean that use of the field price is necessarily prohibited and that the rate-base method is mandatory for all properties in all circumstances. The holding in the case is inconsistent with such a meaning, for the Court declined even to consider an alleged error in the method used, saying,

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[7] This statement of the different results of the two methods, however, should be qualified insofar as it is said to reflect the findings of the Commission itself; for the Commission also said that if the comparison were strictly limited to the results of these methods without the further adjustment made in this case for accelerated amortization, the difference would be decreased by more than half, from a rate differential of 1.3 cents per Mcf to one of 0.6 cents per Mcf.

> "* * * it is the result reached not the method employed which is controlling. * * * If the total effect of the rate order cannot be said to be unjust and unreasonable, judicial inquiry under the Act is at an end. * * * And he who would upset the rate order under the Act carries the heavy burden of making a convincing showing that it is invalid because it is unjust and unreasonable in its consequences." 320 U.S. at 602.

Petitioners refer to a footnote in the *Hope* opinion where it is said that section 6 in its reference to "actual legitimate cost" and "original cost" "comes the closest to supplying any definite criteria for rate making." 320 U.S. at 601 n. 8. But the implication is that the Court does not feel that section 6 completely restricts the Commission to consideration of factors related to costs. Moreover, other statements in the *Hope* decision are adverse to petitioners' contention. At one point the Court said that Congress,

> "* * * has provided no formula by which the 'just and reasonable' rate is to be determined. It has not filled in the details of the general prescription of § 4(a) and § 5(a). It has not expressed in a specific rule the fixed principle of 'just and reasonable.'" 320 U.S. at 600-601.

In the later case of *Colorado Interstate Co.* v. *Federal Power Commission*, 324 U.S. 581, when the general subject was again thoroughly reviewed, the Court, in holding that the Commission was not required to exclude gathering facilities from the rate base and allow "the fair field price of the gas as a commodity" in operating expenses, added, "We do not say that the Commission lacks the authority to depart from the rate-base method. We only hold that the Commission is not precluded from using it. * * *" 324 U.S. at 601. See, also, *Federal Power Commission* v. *Natural Gas Pipeline Co.*, 315 U.S. 575, 586.

Thus the wording of section 4(a) in broad terms of

"just and reasonable" rates, and the construction given the statute in the *Hope*, *Colorado Interstate*, and *Natural Gas* cases, convince us that the allowance of a field price for the utility's own produced gas as an element in the ultimate composition of rates is not unlawful merely because it departs from the traditional rate-base method. But, of course, such an innovation must not lift the rates above the "just and reasonable" standards of the statute.[8]

Petitioners also contend that the formula used results in rates which are not the lowest reasonable rates, and hence they are unlawful under section 5(a), which provides that the Commission "may order a decrease where existing rates * * * are not the lowest reasonable rates." True it is that the rates would be lower were the rate-base method used throughout; and it is equally true that such rates may be "just and reasonable." But we think section 5(a) does not mean that rates which are not the lowest reasonable rates cannot also be "just and reasonable" under section 4(a). Rather, it means that a decrease ordered by the Commission which leaves the utility with rates which are non-confiscatory will not be held invalid; that is, section 5(a) permits but does not compel the Commission to go to the very limit of constitutional power. See *Federal Power Commission* v. *Natural Gas Pipeline Co.*, 315 U.S. at 585–586. If Congress had intended "lowest reasonable" to be the uniform criterion it would not have relegated that standard to a proviso in section 5(a), but instead would have incorporated it in section 4(a). Moreover, it cannot be said that petitioners' interpretation of section 5(a) is required by reason, in view of the obvious practical difficulties which would result from forcing the Commission always to set rates at the very brink of confiscation.

[8] These standards, in turn, are within those of the Constitution. *Federal Power Commission* v. *Natural Gas Pipeline Co.*, 315 U.S. at 586.

Although the Commission cannot be compelled to fix rates at the lowest level of reasonableness, nevertheless it remains true that the primary aim of the Act, in the words of the Supreme Court, is "to protect consumers against exploitation at the hands of natural gas companies." *Federal Power Commission* v. *Hope Natural Gas Co.*, 320 U.S. at 610. See, also, *id.* at 612; *Phillips Petroleum Co.* v. *Wisconsin*, 347 U.S. 672, 685. With this in mind we continue our inquiry whether the rates under review conform with the standards of section 4(a).

The fair field price, which as we have seen results in higher rates that would have resulted from the traditional rate-base method, is not an item of cost. Its inclusion as an amount to be recouped from consumers as though it were a cost incurred by Panhandle must find some other justification within the periphery of the "just and reasonable" standards. It is not an ingredient of any of the usual needs of a regulated utility, that is, to obtain revenues for operating expenses, for preservation of its financial integrity, for capital costs, for servicing of debt and payment of dividends, or for delayed rentals or costs of exploration and development. See *Federal Power Commission* v. *Hope Natural Gas Co.*, 320 U.S. at 605, 615. The Commission, however, advances other factors of an economic character as justification. We may not deny these a place in the total structure underlying rates if, in a balancing of investor and consumer interests, they are brought by evidence and findings into rational relationship to what is "just and reasonable." See *Federal Power Commission* v. *Hope Natural Gas Co.*, 320 U.S. at 603, 615. And in considering whether the two interests are properly balanced we must keep in mind the basic purpose of the statute to protect consumers from excessive rates, though at the same time the statute affords the support of public authority to the regulated utility.

The Commission expresses the basic problem in these words:

> "* * * The question here presented is what method of pricing pipeline-produced gas will, under present-day realities and in the light of the facts of record in this case, best serve the ultimate public interest. * * *"

In resolving this question in favor of the use it made of the field price the Commission states that the traditional rate-base system (1) tends unduly to accelerate consumption of gas, (2) does not sufficiently encourage its discovery and development, thus failing to promote the national interest in both the production and use of natural gas, and finally, (3) that the interest of the public definitely lies in the direction of natural gas production by pipeline systems themselves as distinguished from their complete dependence for gas upon purchases from other producers.[9]

The Supreme Court pointed out in the *Hope* case that the Commission was faced with the problem of determin-

[9] In addition to these reasons, the Commission discussed the "economic incongruity" resulting from use of the traditional rate-base system, whereby Panhandle would receive a different amount of money for the gas it produces than other producers receive for gas in some instances coming from the same well and going to the same consumers. In his dissent in *Federal Power Commission* v. *Hope Natural Gas Co.*, 320 U.S. at 628, and in his concurring opinion in *Colorado Interstate Gas Co.* v. *Federal Power Commission*, 324 U.S. 581, 608, Mr. Justice Jackson dwelt at some length on the "delirious" and "capricious" results of using the rate-base method for natural gas pricing. The Commission quoted extensively from these opinions to bolster its position. Both Commissioner Draper and petitioners contend that adoption of the field price system in the instant case did not correct the evils discussed by Mr. Justice Jackson. Whether or not this be true, and whatever the theoretical merits of the Commission's argument, it cannot provide a basis for setting rates under the Act. The only factors which may move the Commission are those related to the public interest. Symmetry of prices per se has no such relation. The Commission tacitly conceded this when it stated: "Apart from the economic incongruity of such a price situation, there is the fundamental and paramount question, whether such result would be in the public interest. * * *"

ing the amount which a private operator should be allowed to earn from the sale of natural gas across state lines through an established distribution system. "Secs. 4 and 5, not § 7, provide the standards for that determination." 320 U.S. at 612. There West Virginia claimed the Commission should have considered whether the establishment of low rates would not "hasten the abandonment of low-yield high-cost marginal wells." See 320 U.S. at 608-614. In holding that the Commission could not base its order on such "considerations of conservation," the Court pointed out that "the Act does not intrude on the domain traditionally reserved for control by state commissions; and the Federal Power Commission was given no authority over 'the production or gathering of natural gas.' § 1(b)." 320 U.S. at 612-613. On this record we believe the problem of accelerated usage is like those "considerations of conservation" with which the Commission has not been empowered to deal except in problems arising under sections 7 and 11.[10]

As to the remaining two grounds advanced by the Commission, we think they are within the scope of the Act. The first is the need for encouraging exploration and development of gas resources. The *Hope* opinion indicates that the Commission may consider this factor, at least to the extent of allowing recovery of development and exploration costs. Whether the Commission can go further, as it did in the instant case, we need not decide, at least not on the present record, since, as will appear, we base our decision on this point upon a different reason than lack of power in the Commission. The final ground,

[10] The Court in *Hope* pointed out that § 7 may give the Commission authority to consider certain aspects of conservation when deciding whether facilities or services should be abandoned or extended. 320 U.S. at 612. But the Court concluded that no § 7 issue was involved in *Hope*, and we believe it to be clear that none is present here. Conservation may also become the concern of the Commission under § 11, which directs the Commission to aid states which propose to Congress interstate compacts dealing with the conservation, transportation, production, or distribution of natural gas.

the one the Commission appears chiefly to rely upon, is that ownership by pipeline companies of their own producing facilities, instead of their complete dependence for gas supply on purchases from other producers, would serve the public interest by ultimately resulting in lower rates. This would come about, the Commission states, because producing companies would have greater bargaining power when contracting for gas purchases, and would also be able to use their own gas in such a manner that the gas from other companies could be obtained at a relatively uniform rate, thereby enabling the pipeline companies to acquire such gas at a lower price because of certain clauses in the typical gas purchase contracts. The Commission adds a further public interest factor, that consumers remote from production sources would be assured of adequate continuous supply.

While as we have indicated the Commission may be empowered to consider some of these factors it must also, and always, relate its action to the primary aim of the Act to guard the consumer against excessive rates. If the Commission contemplates increasing rates for the purpose of encouraging exploration and development, or the ownership by pipeline companies of their own producing facilities, it must see to it that the increase is in fact needed, and is no more than is needed, for the purpose. Further than this we think the Commission cannot go without additional authority from Congress.

The amount allowed Panhandle for the encouragement referred to is not shown to meet this test by any evidence and findings. Of course the rate increase attributable to producing properties might have a tendency to encourage their ownership, and perhaps also the development of new sources of production, as an even greater increase also might do.[11] But the question is whether a lesser

[11] The findings afford no reasonable basis, however, for believing that the increase in rates, amounting to only 1.3 cents per Mcf on Panhandle's total sales, would cause any appreciable reduction in gas consumption.

amount would suffice.[12] The amount here allowed is not brought into relationship by the evidence and findings with the purposes for which it is granted except that it affords a larger revenue to Panhandle than otherwise it would have. This is not an adequate basis for bringing the resulting rates within the "just and reasonable" standards of the Act. The mere fact that the field price method is used does not vindicate the rates. Its use can be justified only in terms of a demonstrated public interest.[13] In this case an allowance for the desired purposes, assuming they are valid, could be included without resort to the field price system. When the latter method is used the evidence and findings must show that the increase in rates thus caused is no more than is reasonably necessary for the purposes advanced for any increase. Since there is nothing in these proceedings from which such a conclusion could be drawn, they are fatally defective.[14] In

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[12] Commissioner Draper points to several recent cases in which the field price method was not used, *e.g.*, *In the Matter of United Fuel Company*, Opinion No. 258, August 7, 1953, and inquires whether the Commission practice will be to allow the field price only if the pipeline company requests it. It should be noted that the cases cited by Commissioner Draper were decided before the instant case. If the Commission were uniformly to apply the field price system, all risks of exploration and development would be placed upon the pipeline companies. On the other hand, if the Commission gives the companies their option, the traditional rate-base system would naturally be chosen whenever costs of production exceed the field price. In that event, no risks of exploration, development, or production would fall upon the companies, and it would appear that a small margin of profit should suffice to encourage such activities. It is doubtful that the same margin of profit would be required as might be received by producers who bear their own risks. Yet the field price system would seem to have the effect of putting pipeline companies on a par with such producers.

[13] See note 9 *supra*.

[14] As to the necessity of evidence and findings to enable review consistently with statutory authority, see *Capital Transit Co.* v. *Public Utilities Commission*, 93 U.S. App. D.C. 194, 200-202, 213 F. 2d 176, 182-184, *cert. denied*, 348 U.S. 816, and cases cited.

other words, we do not substitute "our opinions for the expert judgment of the administrators to whom Congress entrusted the decision." *Federal Power Commission* v. *Hope Natural Gas Co.*, 320 U.S. at 615. We simply say that if the Commission is now to abandon the treatment historically accorded pipeline-produced gas in rate making on the ground that the ultimate public interest will be better served thereby, the Commission should justify it on the record.

An additional explanation of our view is desirable. We should not be understood to say that whenever the Commission does establish the necessary relationship between means and end, a prescribed rate increase will be lawful. In view of the primary orientation of the Act toward the maintenance of low prices for the consumer, we do not preclude the possibility that a rate increase might be unlawful even though no lower rate could encourage gas production by pipeline companies. On this record, however, if the necessary relationship had been shown we would not consider the rates so high as to be unlawful.

Furthermore, it is seen that when we refer to an "increase" we mean an increase in the rates above those which would result from use of the conventional rate-base method. For, though we hold that method not to be the only one available under the statute, it is essential in such a case as this that it be used as a basis of comparison. It has been repeatedly used by the Commission, and repeatedly approved by the courts, as a means of arriving at lawful—"just and reasonable"—rates under the Act. Unless it is continued to be used at least as a point of departure, the whole experience under the Act is discarded and no anchor, as it were, is available by which to hold the terms "just and reasonable" to some recognizable meaning.

It may be thought that our reference to the rate-base method, as well as our holding that the Commission's use of the field price is invalid because not properly related

to the public interest by the evidence and findings, is inconsistent with the "end result" test employed by the Supreme Court in the *Hope* case. We think not. That test was applied in assessing the reasonableness of rates from the company's point of view. See 320 U.S. at 603. The factors comprising the test were enumerated by the Court—successful business operation, maintenance of financial integrity, attraction of necessary capital, and compensation of investors for risks assumed. See 320 U.S. at 605. From the consumer standpoint no such criteria are available.

On this branch of the case we will set aside the order of the Commission, but will remand the case to enable the Commission, if it so desires, to seek to supplement the record and findings consistently with the views hereinabove expressed. In such proceedings, the Commission should also consider the impact of *Phillips Petroleum Co.* v. *Wisconsin*, 347 U.S. 672, upon its stated reasons for desiring to encourage pipeline companies to produce their own gas. In *Phillips*, decided subsequently to the Commission's order in the instant case, the Supreme Court held that the Federal Power Commission has jurisdiction "over the rates of all wholesales of natural gas in interstate commerce whether by a pipeline company or not and whether occurring before, during, or after transmission by an interstate pipeline company." 347 U.S. at 682. The effect of the decision will probably be to subject to federal regulation the prices paid by pipeline companies for most of the gas they purchase. Consequently, the question of indirectly influencing these prices by the means here chosen by the Commission, such as augmenting the bargaining power of the pipeline company, may be considerably affected.

There is one other respect in which we are unable to agree with the Commission. It found that Panhandle turns over to Phillips Petroleum Company at the latter's Sneed gasoline extraction plant certain volumes of gas

which Panhandle purchases and produces in the Panhandle field. Phillips extracts the gasoline and returns the residue gas to Panhandle for transmission and sale. Panhandle's estimated net revenue from this operation in the test year 1952 was found to be $667,348. Panhandle also owns and operates the Liberal Gasoline Plant in Kansas, at which another portion of its purchased and produced gas is processed and the extracted gasoline and other hydrocarbons sold under contract to the Shamrock Oil and Gas Company. The estimated net revenues from this operation in the test year 1952 were $1,315,577. Prior to its present decision, the Commission had in numerous cases credited such revenues to the operating expenses to be recovered in the rates. See, *e.g.*, *In the Matter of Hope Natural Gas Company*, 3 F.P.C. 150, 178; *In the Matter of Cities Service Gas Company*, 3 F.P.C. 459, 480-481; *City of Columbus* v. *United Fuel Gas Company*, 5 F.P.C. 279, 290. The Commission's action in the first two of these cases received appellate court sanction. See *Hope Natural Gas Co.* v. *Federal Power Commission*, 134 F. 2d 287, 307-308, *reversed on other grounds*, 320 U.S. 591; *Cities Service Gas Co.* v. *Federal Power Commission*, 155 F. 2d 694, 703, *cert. denied*, 329 U.S. 773. The only justification for not following a similar practice in this case, in the words of the Commission, is "the rates which we prescribe for the sale of natural gas for resale should not rest in part upon the fluctuating and unregulated prices of natural gasoline and other liquid hydrocarbons." To this statement is appended a footnote reading, "The market prices of gasoline have varied over the years from less than 2¢ to a high of 8¢ per gallon—the estimated price for the test year 1952 being 6.4¢ per gallon for natural gasoline and 3.04¢ per gallon for liquified petroleum gas."

The Commission feels free to disregard its prior decisions because it concludes that the treatment there given this problem was "bottomed on findings that the processing was 'necessary to make the natural gas marketable

and transportable,' " or "was ' * * * an essential part of the business of transporting and marketing the natural gas.' "[15] The Commission says that the evidence before it would not support a similar finding with respect to Panhandle's extraction operations. Therefore the Commission concludes that Panhandle's extraction operations should be "treated as non-jurisdictional." It appears the Commission did not mean to say that there was a jurisdictional bar to crediting the extraction revenues to operating costs, but rather intended to treat the extraction phase of Panhandle's business as non-jurisdictional in order to implement its policy of eliminating fluctuations in rates. The Commission stated:

> " * * * We do not rest our decision * * * upon the question of jurisdiction, for the record clearly shows that certain of the facilities of Panhandle with respect to which we have unquestioned jurisdiction are jointly used by the gasoline business and in the business of transporting and selling natural gas in interstate commerce for resale. Likewise, expenses are jointly incurred in the purchase, production, gathering, and transportation of the raw natural gas from the wellmouth or points of purchase to the gasoline plants."

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[15] There is some doubt as to whether the Commission is correct in its interpretation of these prior cases. Its finding in *In the Matter of Cities Service Gas Company*, 3 F.P.C. 459, 480-481, was phrased in these words: "This operation is profitable and renders the natural gas more readily marketable and transportable. The extraction of gasoline and other residuals reduces the heat content and consumes a certain volume of the natural gas. Accordingly, the gas consumers are entitled to a fair proportion of the net earnings derived from the processing operations." Thus the Commission found, not that extraction was absolutely necessary for transporting and marketing the gas, but that it was quite helpful. It is true that in affirming, the appellate court referred to the extraction process as an "essential part of the business of transporting and marketing the natural gas * * *," *Cities Service Gas Co.* v. *Federal Power Commission*, 155 F. 2d 694, 703, but this was not the language of the Commission.

The Commission also found that though the extraction process was not necessary to Panhandle's pipeline operations, it was desirable:

> "* * * While we believe the evidence shows it to be a fact that Panhandle would be able to discontinue the extraction of gasoline without incurring serious operating difficulties, nevertheless it is also true that the reduction in the liquid content of the gas through the extraction of the heavier hydrocarbons does improve the operating efficiency of Panhandle's pipeline system."

These facts regarding the usefulness of the extraction process to the transmission operations, the joint use of facilities, and the joint incurring of expenses, coupled with the obvious fact that the extraction process is incident to the over-all pipeline transmission and resale operations, clearly bring the extraction operations within the jurisdiction of the Commission.

We believe the fact that crediting extraction revenues to operating expenses may cause some unspecified and apparently slight effect on rates because of fluctuation in the price of gasoline is not a valid basis for refusing to credit the extraction revenues of Panhandle to operating costs or costs of service. Most of the costs which must be recovered through the rate, such as labor and equipment expenses, are subject to frequent changes, but the Commission has been able to adjust rates satisfactorily. Moreover, it may be noted that were the field price used as the Commisison proposes, it would undoubtedly vary from time to time. The similar problem of fluctuation in gasoline prices would not seem to impose a sufficiently heavy additional burden upon the Commission to justify depriving the consumer of a substantial credit, approximating $2,000,000 in this case, upon the costs to be recouped through the rates.

Since the reason given by the Commission for the failure to give credit for these revenues is unacceptable

to the court, and the Commission has failed to demonstrate a basis for its conclusion that the extraction business should be treated as non-jurisdictional "to the extent that such extraction is not requisite to preparation of the gas for pipe-line transportation," as it said, credit for these revenues should be given. If there were any danger that these desirable extraction operations would be discontinued unless the profits inured solely to the benefit of the stockholders, a different question might be presented. But the history of the problem in this and other cases does not give basis for such a supposition.

We do not disturb the Commission's solution of the problem created by federal income tax savings resulting from accelerated amortization. Such amortization is permitted under certificates of necessity, applicable to emergency facilities, issued pursuant to section 124A of the Internal Revenue Code, 26 U.S.C. § 124A (1952),[16] to encourage construction in the interest of national defense. Panhandle has had an aggregate investment of $10,563,609 certified for accelerated amortization. Under section 124A Panhandle is authorized to charge off this total amount to depreciation in five years, regardless of the estimated useful life of the properties, thus accelerating the amortization of these facilities. The Commission points out that the savings in federal income taxes thus effected for each of the five years will be

> "* * * the difference between what taxes it [Panhandle] would otherwise have been required to pay without accelerated amortization and the taxes actually paid."

The Commission continues,

> "* * * We have computed the tax payments which would have been required without the accelerated amortization which Panhandle is permitted, and for the purposes of the rate schedules under study have

[16] Now § 168 of the Internal Revenue Code of 1954.

considered that Panhandle will be allowed as operating expenses such normalized taxes. This does not allow Panhandle for rate purposes more than a fair return over the long period, but does recognize the grant by Congress of certain temporary tax savings under Section 124A."

Since, however, Congress intended by section 124A only to defer tax liability, and not to provide a fund which could be diverted by Panhandle to the payment of dividends, the Commission further states, "the accruals for taxes in excess of those actually paid should logically be treated by Panhandle, not as free and unrestricted income, but earmarked to provide for the future meeting of such liability." After the facilities have been fully depreciated under the accelerated amortization plan, income taxes will normally be greater, since no further deductions for depreciation will be possible. By setting up a special reserve for the tax saving of the first five years, the Commission insures that this amount will go to meet the increased taxes after that period, rather than being paid out in dividends.

Petitioners object to the Commission's method of "normalizing" income tax expense, by which all computations are made as if amortization were not accelerated. They contend that in order to hold rates to a "just and reasonable" level, the savings effected by the accelerated amortization should partly inure to the benefit of consumers. They propose that this be accomplished by treating the saving simply as ordinary depreciation would be treated. That is, in computing recoverable expenses, the income tax expense would be figured at its actual, instead of "normalized," amount, but depreciation expense would be set at the accelerated figure. Thus the same saving would accrue to Panhandle, but under the name of depreciation expense rather than income tax expense. The difference, however, would lie in this, that amounts recovered as depreciation expense are deducted from the rate base. Thus in essence petitioners' plan would allow Panhandle

its yearly saving for the five year period, but would deduct the amount of that saving each year from the rate base.

This plan was rejected by the Commission, which concluded, we think correctly, that the intent of Congress reflected in section 124A is not to benefit consumers but rather the taxpayer in order to encourage construction of certain emergency types of facilities. Were the tax savings deducted from the rate base, the taxpayer here would not receive the intended benefit. The valuations upon which it is entitled to earn a fair rate of return would be decreased by the amount of the savings. In placing the savings at the disposal of Panhandle under the limitations specified, the Congressional intent is effectuated. The funds go into a reserve account for the payment of the deferred taxes to accrue after the five year amortization period. Though thus earmarked, the funds are available for income-producing purposes. Unless this is permitted, it is difficult to see how Panhandle could benefit substantially from section 124A.[17] This statute, unlike

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[17] Petitioner City of Detroit and Commissioner Doty contended that Panhandle would benefit by being able to write off the property in a short period of time. But even if that be considered an advantage, the question is whether it alone would fulfill Congressional intent. Panhandle points out that if it had to deduct the tax saving from the rate base, it would probably lose in the long run. The two primary uses for the saving would be reinvestment, by virtue of which the money would again go into the rate base, and retirement of debt. Panhandle argues forcefully that if it used the tax saving to retire debt, it would save only the interest on its debt, while giving up 5.75% return on that same amount. Thus Panhandle would suffer a net loss, since the interest cost of debt is generally less than 5.75%. On the other hand, if the tax saving were used to reinvest in plant, there would also probably be a net loss because there would inevitably be a lag between the time the money becomes available and the time it is added to the rate base. Thus it seems clear that if rapid writing off of investment be an advantage which would accrue to Panhandle under petitioners' proposal, it might be too easily offset by disadvantages for us to conclude that it was the sole benefit to investors contemplated by Congress. This conviction is reinforced, of course, by the fact that there is no indication of a Congressional intent to benefit consumers.

the Natural Gas Act itself, is not for consumer benefit. It has a different public policy and should be given effect as intended by Congress. Furthermore, the solution of the Commission does not result in higher rates to the consumer. It simply does not operate to reduce them. It aids Panhandle but neither aids nor harms petitioners. We think this is the result sought by Congress.

Finally, we agree with the Commission that it was not required to reopen the proceedings. Petitioners sought such reopening to permit proof of increased sales volume. Evidence of such increase was offered in the effort to show that the unit cost of service would be reduced. The parties agree, however, that 1952 was a proper test year, and the Commission made its calculations on the basis of evidence available as to that year. We find no abuse of discretion in the Commission's refusal to reopen for evidence subsequently available, especially as there is no clear indication that the evidence offered, considered with all factors involved, would likely lead to a different result. See *Interstate Commerce Commission* v. *Jersey City*, 322 U.S. 503, 514-515.

Because of our view that allowance of the fair field value of Panhandle's own produced gas as an operating expense is not here supported by the evidence and findings to be in the public interest, and because of our disagreement with respect to the Commission's failure to credit the revenues of the gasoline extraction operations, the order under review is

*Set aside and the cases are remanded to the Commission for further proceedings not inconsistent with this opinion.*

UNITED STATES COURT OF APPEALS
FOR THE DISTRICT OF COLUMBIA CIRCUIT

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OCTOBER TERM 1955.

No. 12,351

CITY OF DETROIT, MICHIGAN, A MUNICIPAL CORPORATION,
*Petitioner,*

v.

FEDERAL POWER COMMISSION, *Respondent,*
PANHANDLE EASTERN PIPE LINE COMPANY, *Intervenor.*

OCTOBER TERM 1955.

No. 12,359

COUNTY OF WAYNE, MICHIGAN, A MUNICIPAL CORPORATION AND BODY POLITIC, *Petitioner,*

v.

FEDERAL POWER COMMISSION, *Respondent,*
PANHANDLE EASTERN PIPE LINE COMPANY, *Intervenor.*

On Petitions for Review of Order of the Federal Power Commission.

Before: Fahy, Danaher and Bastian, Circuit Judges.

**Judgment**

These cases came on to be heard on the transcript of the record from the Federal Power Commission, and were argued by counsel.

ON CONSIDERATION WHEREOF, It is ordered and adjudged by this Court that the order of the said Federal Power Commission on review herein be, and the same is hereby, set aside, and that these cases be, and they are hereby, remanded to the said Federal Power Commission for further proceedings not inconsistent with the opinion of this Court.

Dated: December 15, 1955.

Per Circuit Judge Fahy.
/s/ C.F.

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AND BODY POLITIC, *Petitioner,*

v.

FEDERAL POWER COMMISSION, *Respondent,*
PANHANDLE EASTERN PIPE LINE COMPANY, *Intervenor.*

Before: Fahy, Danaher, and Bastian, Circuit Judges, in Chambers.

**Order**

Upon consideration of the intervenor's petition for rehearing and of respondent's petition for rehearing and of the answer thereto filed by City of Detroit, it is

ORDERED by the Court that the aforesaid petitions be, and they are hereby, DENIED.

Per Curiam.

Dated: February 28, 1956

DANAHER, Circuit Judge, dissenting in part: When these cases were before us I had certain misgivings. Apart

from my feeling that, in principle, natural gas should be regarded as a commodity and hence a competing fuel, I am concerned about the nonjurisdictional gasoline sales. I think the Commission might well have convinced us that it had a proper basis for excluding the gasoline extraction credits. The petitions for rehearing have bestirred my doubts to the extent of leading to believe that we should rehear the parties on this point, and I would have granted rehearing accordingly.

## STATUTE INVOLVED

The pertinent provisions of the Natural Gas Act, 52 Stat. 821 (1938) as amended 15 U.S.C. § 717 *et seq.*, are printed in the Appendix to this petition, beginning at pp. 26a et seq.

Section 1. (b) "The provisions of this act shall apply to the transportation of natural gas in interstate commerce, to the sale in interstate commerce of natural gas for resale for ultimate public consumption for domestic, commercial, industrial, or any other use, and to natural-gas companies engaged in such transportation or sale, but shall not apply to any other transportation or sale of natural gas or to the local distribution of natural gas or to the facilities used for such distribution or to the production or gathering of natural gas." [52 Stat. 821 (1938); 15 U.S.C. § 717(b)]

Section 2. (5) " 'Natural gas' means either natural gas unmixed, or any mixture of natural and artificial gas." [52 Stat. 822 (1938); 15 U.S.C. § 717b]

Section 4. (a) "All rates and charges made, demanded, or received by any natural-gas company for or in connection with the transportation or sale of natural gas subject to the jurisdiction of the Commission, and all rules and regulations affecting or pertaining to such rates or charges, shall be just and reasonable, and any such rate or charge that is not just and reasonable is hereby declared to be unlawful." [52 Stat. 822 (1938); 15 U.S.C. § 717c]

Section 5. (a) "Whenever the Commission, after a hearing had upon its own motion or upon complaint of any State, municipality, State commission, or gas distributing company, shall find that any rate, charge, or classification demanded, observed, charged, or collected by any natural-gas company in connection with any transportation or sale of natural gas, subject to the jurisdiction of the Commission, or that any rule, regulation, practice, or contract affecting such rate, charge, or classification is unjust, unreasonable, unduly discriminatory, or preferential, the

Commission shall determine the just and reasonable rate, charge, classification, rule, regulation, practice, or contract to be thereafter observed and in force, and shall fix the same by order: *Provided, however,* That the Commission shall have no power to order any increase in any rate contained in the currently effective schedule of such natural-gas company on file with the Commission, unless such increase is in accordance with a new schedule filed by such natural-gas company; but the Commission may order a decrease where existing rates are unjust, unduly discriminatory, preferential, otherwise unlawful, or are not the lowest reasonable rates." [52 Stat. 823 (1938); 15 U.S.C. § 717d]

Section 19. (a) "Any person, State, municipality, or State commission aggrieved by an order issued by the Commission in a proceeding under this act to which such person, State, municipality, or State commission is a party may apply for a rehearing within thirty days after the issuance of such order. The application for rehearing shall set forth specifically the ground or grounds upon which such application is based. Upon such application the Commission shall have power to grant or deny rehearing or to abrogate or modify its order without further hearing. Unless the Commission acts upon the application for rehearing within thirty days after it is filed, such application may be deemed to have been denied. No proceeding to review any order of the Commission shall be brought by any person unless such person shall have made application to the Commission for a rehearing thereon."

Section 19. (b) Any party to a proceeding under this act aggrieved by an order issued by the Commission in such proceeding may obtain a review of such order in the circuit court of appeals of the United States[8] for any circuit wherein the natural-gas company to which the order relates is located or has its principal place of business, or in

[8] Circuit Court of Appeals of the United States was redesignated as "United States Court of Appeals" by Act of June 25, 1948, 62 Stat. 870.

the United States Court of Appeals for the District of Columbia, by filing in such court, within sixty days after the order of the Commission upon the application for rehearing, a written petition praying that the order of the Commission be modified or set aside in whole or in part. A copy of such petition shall forthwith be served upon any member of the Commission and thereupon the Commission shall certify and file with the court a transcript of the record upon which the order complained of was entered. Upon the filing of such transcript such court shall have exclusive jurisdiction to affirm, modify, or set aside such order in whole or in part. No objection to the order of the Commission shall be considered by the court unless such objection shall have been urged before the Commission in the application for rehearing unless there is reasonable ground for failure so to do. The finding of the Commission as to the facts, if supported by substantial evidence, shall be conclusive. If any party shall apply to the court for leave to adduce additional evidence, and shall show to the satisfaction of the court that such additional evidence is material and that there were reasonable grounds for failure to adduce such evidence in the proceedings before the Commission, the court may order such additional evidence to be taken before the Commission and to be adduced upon the hearing in such manner and upon such terms and conditions as to the court may seem proper. The Commission may modify its findings as to the facts by reason of the additional evidence so taken, and it shall file with the court such modified or new findings, which if supported by substantial evidence, shall be conclusive, and its recommendation, if any, for the modification or setting aside of the original order. The judgment and decree of the court, affirming, modifying, or setting aside, in whole or in part, any such order of the Commission, shall be final, subject to review by the Supreme Court of the United States upon certiorari or certification as provided in sections 239 and 240 of the Judicial Code, as amended (U.S.C., title 28, secs. 346 and 347)." [52 Stat. 831 (1938); 15 U.S.C. §717r]

PETITION FOR REHEARING OF RESPONDENT
FEDERAL POWER COMMISSION

FILED
MAY 25 19
HAROLD B. WILLEY

# United States Court of Appeals
# For the District of Columbia Circuit

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No. 12,351

CITY OF DETROIT, MICHIGAN, *Petitioner*

v.

FEDERAL POWER COMMISSION, *Respondent*
PANHANDLE EASTERN PIPE LINE COMPANY, *Intervenor*

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No. 12,359

COUNTY OF WAYNE, MICHIGAN, *Petitioner*

v.

FEDERAL POWER COMMISSION, *Respondent*
PANHANDLE EASTERN PIPE LINE COMPANY, *Intervenor*

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**Petition for Rehearing on Petitions for Review of an Order of the Federal Power Commission**

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JANUARY 1956

## QUESTIONS PRESENTED ON REHEARING

(1) Should the Federal Power Commission in fixing the rates of Panhandle Eastern Pipe Line Company, a natural-gas company under the Natural Gas Act, be required to use the rate-base formula either as "a basis of comparison" or as "a point of departure" (Opinion p. 16) when it includes the field price of Panhandle produced gas in the cost of service and excludes Panhandle's production and gathering properties from the rate base?

(2) Is there any basis for the Court to interfere with the discretion of the Commission and require that net revenues from the gasoline-extraction operations of Panhandle be credited to gas service operating expenses when the Commission was unwilling to find and did not find that the gasoline-extraction operations were essential to the transportation and sale of natural gas in interstate commerce?

(3) Is the Court justified in extending its review of the Commission's order beyond the authority for judicial review granted in the Natural Gas Act by considering *sua sponte* the question of validity of the use of the field price as affected by the lack in the proceedings of anything from which the conclusion could be drawn that the increase in rates is no more than is reasonably necessary for the purposes advanced?

(4) Is the Court in error in setting the Commission's order aside when the Petitioners have not met their burden of proof?

# INDEX


Page

Questions Presented on Rehearing ..... 1

Grounds for Rehearing ..... 2

Introduction ..... 2

Argument ..... 4

I. The Court erred in holding that the prudent investment rate-base formula must be used as a basis of comparison or at least as a point of departure ..... 4

II. The Court erred in holding that the net revenues from extraction operations should be credited to gas service operating expenses .... 16

III. The Court could not consider sua sponte, the question of the validity of the use of the field price as affected by the lack in the proceedings of anything from which the conclusion could be drawn that the increase in rates is no more than is reasonably necessary for the purpose advanced ..... 18

IV. The Court erred in setting aside the Commission's rate order when the petitioners have not met the burden of proof ..... 22

Conclusion ..... 22

Certificate of Counsel ..... 23

Appendix A. Natural Gas Act—Pertinent Sections ..... 24


## CASES CITED


*Colorado Interstate Gas Co.* v. *Federal Power Commission*, 324 U. S. 581 (1945) ..... 6, 15

*Colorado Interstate Gas Co.* v. *Federal Power Commission*, 209 F. 2d 717 (1953) ..... 16

*Douglass* v. *County of Pike (Missouri)*, 101 U. S. 677 (1879) ..... 15

*Federal Power Commission* v. *Colorado Interstate Gas Co.*, 348 U. S. 492 (1955) ..... 20

*Federal Power Commission* v. *Hope Natural Gas Co.*, 320 U. S. 591 (1944) 6, 7, 12, 13, 14, 15, 22

*Federal Power Commission* v. *Natural Gas Pipeline Co.*, 315 U. S. 575 (1942) ..... 9, 10, 11, 12, 13, 15

*Hope Natural Gas Co.* v. *Federal Power Commission*, 134 F.2d 287 [C.C.A. 4 (1943)] ..... 13, 14, 15

*Lindsley* v. *Natural Carbonic Gas Co.*, 220 U. S. 61 (1911) ..... 15

*Panhandle Eastern Pipe Line Co.* v. *Federal Power Commission*, 324 U. S. 635 (1945) ..... 20

*Pennsylvania* v. *West Virginia*, 262 U. S. 553 (1923) ..... 9

Page

*Smyth* v. *Ames*, 169 U. S. 466 (1898) ..... 10
*State Corp. Com.* v. *Federal Power Commission*, 206 F.2d 690 ..... 16
*Unemployment Compensation Com. of Alaska* v. *Aragon*, 329 U. S. 143 (1946) ..... 21
*United States* v. *Tucker Truck Lines*, 344 U. S. 33 (1952) ..... 21

## STATUTES CITED

Bituminous Coal Act of 1937, c. 127, 50 Stat. 72 ..... 8, 9
Commerce Court Act, June 18, 1910, c. 309, 36 Stat. 545 ..... 8
Interstate Commerce Act, February 4, 1887, c. 104, 24 Stat. 379 ..... 8
Natural Gas Act,
June 21, 1938, c. 556, 52 Stat. 821; 15 U.S.C., 717 et seq. .....8, 24
February 7, 1942, c. 49, 56 Stat. 83; 15 U.S.C., 717 f(e-g) .....8, 24
July 25, 1947, c. 333, 61 Stat. 459; 15 U.S.C., 717 f(h) .....8, 24
March 27, 1954, c. 115, 68 Stat. 36; 15 U.S.C., 717 (c) .....8, 24
Section
19 (a) ..... 19
19 (b) ..... 19
Transportation Act of 1920, c. 91, 41 Stat. 488 ..... 8

## MISCELLANEOUS CITATIONS

Congressional Record, Vol. 81, Pt. 6, pp. 6720-6733 and Pt. 8, pp. 8918-8919, 9312-9317 ..... 9

# United States Court of Appeals
# For the District of Columbia Circuit

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No. 12351

CITY OF DETROIT, MICHIGAN, a Municipal Corporation, *Petitioner*

v.

FEDERAL POWER COMMISSION, *Respondent*
PANHANDLE EASTERN PIPE LINE COMPANY, *Intervenor*

---

No. 12359

COUNTY OF WAYNE, MICHIGAN, a Municipal Corporation and Body Politic, *Petitioner*

v.

FEDERAL POWER COMMISSION, *Respondent*
PANHANDLE EASTERN PIPE LINE COMPANY, *Intervenor*

---

**Petition for Rehearing on Petitions for Review of an Order of the Federal Power Commission**

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## RESPONDENT'S PETITION FOR REHEARING

The Federal Power Commission, Respondent, respectfully petitions this Court for rehearing in the above-entitled consolidated cases in regard to those parts of the Court's opinion entered December 15, 1955, holding (1) that the Commission's allowance in Panhandle Eastern Pipe Line Company's cost of service of the field value of gas produced

by Panhandle in fixing Panhandle's rates is invalid (Opinion p. 16); and (2) that the Commission erred in not crediting to Panhandle's operating expenses Panhandle's net revenues from gasoline extraction operations (Opinion pp. 17-21).

## GROUNDS FOR REHEARING

The Federal Power Commission respectfully petitions the Court for rehearing on the following grounds:

1. The Court erred in holding that the prudent-investment rate-base method must be used as a basis of comparison or at least as a point of departure before any other method may be used for rate fixing under the Natural Gas Act.

2. The Court erred in holding that net revenues from extraction operations should be credited to operating expenses.

3. The Court extended its review of the Commission's order beyond the authority for judicial review granted in the Natural Gas Act by considering *sua sponte* the question of the validity of the use of the field price as affected by the lack in the proceedings of anything from which the conclusion could be drawn that the increase in rates is no more than is reasonably necessary for the purposes advanced.

4. The Court erred in setting aside the Commission's rate order when the Petitioners have not met the burden of proof.

## INTRODUCTION

In the Court's opinion the order of the Commission under review is affirmed in all but two parts: (1) The Court held the Commission to be in error in excluding from the rate base of Panhandle the Company's net investment of its production facilities and in lieu thereof in using as a part of Panhandle's cost-of-service the field-price formula for Panhandle's own produced gas; and (2) the Court held the Commission to be in error in excluding the gasoline-

extraction operations, revenues and costs, from Panhandle's cost of service.

The holdings of the Court in these two parts so materially affect the administration of the Natural Gas Act in the fixing of just and reasonable rates thereunder that the respondent, Federal Power Commission, urges the Court to give further consideration to the Commission order here under review and to affirm that order in these two parts as in accord with constitutional principles and within the authority granted by the Natural Gas Act upon evidence which the Court has already held to be substantial.

Although the Court purports to allow the Commission complete freedom to use any formula which will fix just and reasonable rates (Opinion p. 15), actually the ruling negatives that freedom by requiring adherence to the rate-base formula "as a basis of comparison" or "as a point of departure" (Opinion p. 16). Moreover, on the second phase of the Court's decision upon which reconsideration is sought, it is respectfully submitted that the Commission found the gasoline-extraction operations of Panhandle to be outside of those operations which are essential for the interstate transportation and sale of natural gas upon evidence which the Court recognizes as substantial, and, therefore, the Court should not substitute its own judgment for that of the Commission and compel the inclusion of non-jurisdictional operations as a part of the interstate cost of service.

If the decision of the Court in these two parts is allowed to stand, the Commission will be bound, at least in part, to a single formula for rate-making, the prudent-investment rate-base formula, and will be required, in fixing the rates of a natural-gas company subject to the Natural Gas Act, to consider the cost of operation and the revenues of activities which are not essential to the interstate sale or interstate transportation of natural gas to which alone the statute relates.

## ARGUMENT

### I

### The Court Erred in Holding That the Prudent-Investment Rate-Base Formula Must be Used as a Basis of Comparison or at Least as a Point of Departure

The Commission used the prudent-investment or rate-base method to establish a rate base on which it allowed Panhandle a return of 5¾ percent on those activities which the Commission likened to the transportation enterprise (R. 9813, 9822, 9759). The Commission did not, however, include in the rate base any of the production facilities or production extraction facilities of Panhandle (R. 9815), but included in lieu thereof the commodity value of Panhandle produced gas as a part of the cost of service (R. 9818) and excluded the cost of producing its own gas (R. 9748). The commodity value was computed by the Commission by applying to Panhandle's production "the weighted average arm's length prices of gas at the wellhead in the fields where this gas is produced" (R. 9746-7). The use of this commodity value in lieu of including Panhandle's production and extraction facilities in the rate base and its cost of production and extraction operations in the cost of service resulted in an increase in the rates over what the rates would be if the prudent-investment or rate-base method were applied to the production operations of Panhandle (R. 9748).

The figures found by the Commission as the rate base are uncontested, as is also the rate of return allowed thereon. Furthermore, the Court accepted "as supported by substantial evidence the findings of the Commission regarding the weighted average arm's length prices paid at the wellhead" (Opinion pp. 6-7).

Both the Court and the Commission recognized that the use of the field-price formula was a departure from prior Commission practice, but the Court directed its attention first to the question of whether "the larger amount required to be paid by consumers . . . that would be charged

were the rate-base method followed throughout, removes the prescribed rates from a 'just and reasonable' category" (Opinion p. 7). In other words, the Court did not consider the field-price method on its own intrinsic worth, but related it to the rate-base method. If the field-price method is proper—and the Court recognizes its suitability (Opinion pp. 13-15)—it is proper on its own merits and does not become suspect because it produces larger amounts than would be produced by some other method. By tying the field price to the rate-base method so that "larger" amounts are said to be given, the Court itself appears to be inconsistent with its holding that the Commission is not required to set rates always at the very brink of confiscation (Opinion p. 10). At no place in its opinion does the Court expressly find the rates fixed by the Commission to be unjust or unreasonable. Nevertheless, it disregards the Commission's finding that, as fixed, they will be just and reasonable, and in setting the Commission's order aside says that if the field-price method is used, any increase in the rates "above those which would result from the use of the conventional rate-base method" must be justified by comparison with that method (p. 16). Also, the Court states that the field price is not an item of cost (p. 10).

In its opinion the Court is discussing items of cost under the rate-base method. But the theory of the Commission in the use of the field price is that it may be a cost—an economic cost—or the price necessary to induce pipeline companies to own and acquire reserves. And the Court recognizes that the ownership of reserves, including the exploration and development of reserves, is within the rate-fixing framework of the Act.

One basis of the Commission's decision in Opinion No. 269 was the economic aspect of the production phase of the natural-gas business. The Commission referred to Mr. Justice Jackson's dissent in the *Hope* case that the problem of fixing rates for the production properties should be approached "as the performance of economic

functions, not as the performance of legalistic rituals" (R. 9753). We are not concerned with the legal effect to be given Mr. Justice Jackson's dissents in the *Hope*[1] and *Colorado Interstate*[2] cases, for the point here made is that the Commission merely adopted the economic and social arguments advanced in the dissents as some of the reasons for its conclusion that the field price was in the long-range public interest. The Court here seems to be preoccupied with its notions of historical cost and rate base, as a consequence of which it disagrees with the logic of the Commission's reasoning.

Thus, the Court finds that the "economic incongruity" resulting from the use of the rate-base method whereby Panhandle would receive a different amount of money for the gas it produces than other producers receive for gas coming from the same well "cannot provide a basis for setting rates under the Act" (p. 12). But the Commission did not use the field-price method merely to provide symmetry of prices *per se*. The Commission's object was not to equate all prices to one level. The object was to accord Panhandle's production a value as a commodity, to be treated just the same as similar gas which Panhandle purchases from others (R. 9744). In other words, the pipeline company as owner of reserves may be entitled to the same economic return as other owners if it is to be encouraged to own and acquire reserves.

Because of the Court's preoccupation in weighing the field-price method on the scales of the rate-base method, the Court fell into the error in concluding that the Commission's findings failed to show that the so-called "larger amount" was required and is no more than required. The reasonableness of the field-price standard should not be judged by whether it results in a higher price than the rate-base method or any other method. The standard itself should be evaluated in the light of its own inherent

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[1] *F.P.C.* v. *Hope Natural Gas Co.*, 320 U.S. 591.

[2] *Colorado Interstate Gas Co.* v. *F.P.C.*, 324 U.S. 581.

reasonableness. Thus, if the Commission is free to use the field-price method (and the Court found that the field prices actually used were based on substantial evidence), then the field price itself fixes the amount which should be allowed to encourage the exploration, development, and ownership of reserves. There is no criterion of how much less than the field price should be allowed. The Commission should not engage in a guessing contest. If pipeline companies are to be given the economic incentive to accomplish the objectives which the Court approves, then they may be given the field price, and not something less or more. In this connection, the statement of the Court that "[T]he mere fact that the field price method is used does not vindicate the rates" (Opinion p. 15) appears inconsistent with the doctrine that the Commission is not restricted to the use of any specific formula. The Court assumes that an amount was given to Panhandle without relevance to any standard. For the Court stated: "In this case an allowance for the desired purposes, assuming they are valid, could be included without resort to the field price system" (Opinion p. 15). But the whole point of the field-price doctrine is that the field price itself as the measure of the value to be attributed to the gas in order to achieve the objectives is itself a standard. If the field price method is proper, then the rates fixed thereunder are proper, especially in view of the statement of the Court that "if the necessary relationship had been shown we would not consider the rates so high as to be unlawful."[3] In other words, a rate base is not necessary at all to determine the justness and reasonableness of the allowance to pipeline-produced gas. As Mr. Justice Jackson stated in his dissenting opinion in the *Hope* case (320 U.S. at 647-648) this involves a unique industry:

> "Is it necessary to a 'reasonable' price for gas that it be anchored to a rate base of any kind? Why did courts in the first place begin valuing 'rate bases' in

[3] Even in this context the Court probably was referring to the fact that the use of the field-price method in the *Panhandle* case resulted in an increase over the rate-base method of 1.3 cents per Mcf.

> order to 'value' something else? . . . But the gas fields turn this method topsy turvy. Gas itself is tangible, possessible, and does have a market and a price in the field. The value of the rate base is more elusive than that of gas. It consists of intangibles—leaseholds and freeholds—operated and unoperated—of little use in themselves except as rights to reach and capture gas . . . Gas is what Hope sells and it can be directly priced more reasonably and easily and accurately than the components of a rate base can be valued. Hence the reason for resort to a roundabout way of rate base price fixing does not exist in the case of gas in the field."

In thus establishing the prudent investment rate-base method as the standard of justness and reasonableness by which other methods of determining natural gas rates must be measured, the Court not only restricts the exercise of the Commission's judgment and choice of a formula, but engages in the legislative rate-making process of balancing complex economic factors, a process which is the essence of rate making and which has been entrusted by Congress exclusively to its agent, the Federal Power Commission.

Even in the Natural Gas Act Congress did not prescribe a formula to be followed in fixing the interstate gas rates, although in a 1920 amendment to the Interstate Commerce Act and in the Bituminous Coal Act it had spelled out the method to be followed under certain circumstances. Section 1 of the Interstate Commerce Act as originally enacted provided that all charges for the services specified should be "reasonable and just" (24 Stat. 379) and these words were reversed in 1910, again without prescribing any formula (36 Stat. 545). A specific formula for rate fixing, however, was prescribed in 1920 by adding section 15a(2) to provide that the Commission should fix rates to enable the carriers to earn "an aggregate annual net railway operating income equal, as nearly as may be, to a fair return upon the aggregate value of the railway property

of such carriers held for and used in the service of transportation" (41 Stat. 488).

In the Bituminous Coal Act of 1937 (c. 127, 50 Stat. 72, 80, Part II (c)), Congress gave to the Bituminous Coal Commission power to establish maximum prices for coal to yield a reasonable return above the weighted average total cost in each district, provided "that no maximum price shall be established for any mine which shall not yield a fair return on the fair value of the property."

In refusing to tie the hands of the Commission by anchoring it, even indirectly, to a prescribed rate formula, Congress was undoubtedly aware of the complexities of regulation in the natural gas industry and of the need to give the Commission wide latitude for the exercise of its discretion and informed judgment.[4] It was those complexities that resulted in numerous jurisdictional conflicts and prompted Mr. Justice Brandeis to say in a dissenting opinion:

> "In no other field of public service regulation is the controlling body confronted with factors so baffling as in the natural gas industry; and in none is continuous supervision and control required in so high a degree.
>
> "The decisions to be made would be of the character which calls for the informed judgment of a board of experts." *Pennsylvania* v. *West Virginia*, 262 U.S. 553, 621 (1923).

The Supreme Court has had several opportunities to extend its jurisdiction into the Commission's rate-making domain, but in every instance it has exercised restraint by resisting the temptation to tether the Commission to any rate formula, even as a standard of comparison.

This restraint was manifested in *Federal Power Commission* v. *Natural Gas Pipeline Co.*, 315 U.S. 575 (1942), the

[4] See Congressional Record, Vol. 81 pt. 6, pp. 6720-6733 and pt. 8, pp. 8918-8919, 9312-9317.

first case to reach the Supreme Court under the Natural Gas Act in which the Commission, for the purpose of an interim rate reduction, accepted the company's estimate of its "fair value" or "reproduction cost" rate base. In reversing the lower court and affirming the Commission's rate order, the Supreme Court said (p. 586):

> "The Constitution does not bind rate-making bodies to the service of any single formula or combination of formulas. Agencies to whom this legislative power has been delegated are free, within the ambit of their statutory authority, to make the pragmatic adjustments which may be called for by particular circumstances."

Messrs. Justices Black, Douglas, and Murphy, in a concurring opinion emphasized the Commission's freedom in this respect (pp. 601-602):

> "Furthermore, since this case starts a new chapter in the regulation of utility rates, we think it important to indicate more explicitly than has been done the freedom which the Commission has both under the Constitution and under this new statute. While the opinion of the Court erases much which has been written in rate cases during the last half century, we think this is an appropriate occasion to lay the ghost of *Smyth* v. *Ames*, 169 U.S. 466, which has haunted utility regulation since 1898. That is especially desirable lest the reference by the majority to 'constitutional requirements' and to 'the limits of due process' be deemed to perpetuate the fallacious 'fair value' theory of rate making in the limited judicial review provided by the Act."

The minority, in its concurring opinion, pointed out how experience had demonstrated the "fair value" rule to be unworkable (pp. 602-606) and said (p. 606):

> "The Commission may now adopt, if it chooses, prudent investment as a rate base—the base long advocated by Mr. Justice Brandeis. And . . . there could be no con-

> stitutional objection if the Commission adhered to that formula and rejected all others."

The minority's disapproval of the "fair value" rate base and their approval of the "prudent investment" rate base are emphatically clear, which makes especially noteworthy the fact that, despite their personal views, they reiterated that in fixing rates, the Commission is not bound by any standard other than that provided by Congress. They said (pp. 606, 607):

> "Yet it is important to note, as we have indicated, that Congress has merely provided in §5 of the Natural Gas Act that the rate fixed by the Commission shall be 'just and reasonable'. It has provided no standard beyond that . . . The Commission has a broad area of discretion for selection of an appropriate rate base. . . . It is not the function of the courts to prescribe what formula should be used. The fact that one may be fair to investors does not mean that another would be unfair. The decision in each case must turn on considerations of justness and fairness which cannot be cast into a legalistic formula. The rate of return to be allowed in any given case calls for a highly expert judgment. That judgment has been entrusted to the Commission. There it should rest."

The *Natural Gas Pipeline* case presents a striking parallel to the cases now before the Court in that there, as here, the method followed by the Commission resulted in higher rates than if an alternative method had been used. The "reproduction cost" rate base, used by the Commission, was larger by several million dollars than a "prudent investment" rate base would have been. *Id.* 587. The Supreme Court was fully aware of that disparity. It was also mindful of the consumers' interest. The minority, in its concurring opinion, said (pp. 606-608):

> "The requirements of 'just and reasonable' embrace, among other factors, two phases of the public interest:

> (1) the investor interest; (2) the consumer interest . . . The consumer interest cannot be disregarded in determining what is a 'just and reasonable' rate. . . . The rights of the public are not to be ignored. . . . 'The public cannot properly be subjected to unreasonable rates in order simply that stockholders may earn dividends'."

The Supreme Court was then presented with a golden opportunity, at the outset of judicial interpretation of the Natural Gas Act, to state the rate base formulae to be thereafter used as the point of departure from which any other rate must be justified. The same elements by which to try to justify such a pronouncement were present in that case as in these, namely (1) the possibility of lower rates by use of the prudent-investment rate base method instead of the method used by the Commission, and (2) the need to protect the public interest. The Court, however, decided to forego the opportunity to strait-jacket the exercise of the Commission's judgment within such a narrow confine.

Some of the sound reasoning back of the Court's decision is found in the concurring opinion:

> "The investor and the consumer interests may so collide as to warrant the rate-making body in concluding that a return on historical cost or prudent investment, though fair to investors, would be grossly unfair to consumers. The possibility of that collision reinforces the view that the problem of rate-making is for the administrative experts, not the courts, and that the *ex post facto* function previously performed by the courts should be reduced to the barest minimum consistent with the statutory mandate for judicial review." *Id.*, p. 608.

The case of *Federal Power Commission* v. *Hope Natural Gas Co.*, 320 U.S. 591 (1944) is of especial pertinence to the cases now before this Court because in that case the Supreme Court struck down the attempt of the Fourth

Circuit Court, in *Hope Natural Gas Co.* v. *Federal Power Commission*, 134 F. 2d 287 (C.C.A. 4 (1943)), to anchor the Commission to a fair value rate-base standard, which had been used with judicial approval for more than 40 years. In so doing, the Court took occasion to reaffirm its holding in the *Natural Gas Pipeline Company* case that the Commission is not bound to the use of any single formula or combination of formulae. *Federal Power Commission* v. *Hope Natural Gas Co., supra*, p. 602.

The Commission, heeding the Supreme Court's expressions of approval in the *Natural Gas Pipeline Company* case, used for the Hope Natural Gas Company rates, the prudent-investment rate base instead of the time-honored "fair value" method used previously by other agencies. The lower court in reversing the Commission took the view that, "Not to be confiscatory, rates must allow a fair return upon the present fair value of the property"; that, in view of changes in price levels, the use of prudent investment in determining the base did not provide a proper measure of present fair value; and that "The adoption by the Commission of investment cost less depreciation as the rate base, therefore, is arbitrary and unreasonable, does not conform to statutory requirements and is violative of the due process clause of the 5th Amendment to the Constitution." (*Id.* 300)

Just as this Court has now anchored the Commission to the prudent investment rate base as a "basis of comparison" and a "point of departure" (Opinion p. 16), so the Circuit Court of Appeals, Fourth Circuit, tried, in this *Hope Natural Gas Co.* decision, *supra*, to tie the Commission to the "present fair value" standard in the following language:

> ". . . in judging whether the rate is confiscatory or not, historical cost under the prudent investment theory can be adopted as the rate base without reference to other matters affecting value *only where it can reasonably be found to represent present fair value.*" (*Id.* 300). (Emphasis supplied).

The striking similarities between the *Hope Natural Gas Company* cases and the cases now before this Court deserve emphasis in view of the importance of the issues involved. There, as here, the Commission departed from the traditional rate-making formula that for many years had enjoyed wide-spread usage and judicial sanction. The "present-fair-value" method, however, had enjoyed popularity three times as long as the "prudent-investment" method has been in vogue. There, as here, the Commission, dutifully and in good faith, followed the regulatory pattern indicated by the Supreme Court in forward-looking majority and minority opinions. There, as here, the lower Court viewed with favor the regulatory pattern to which it was accustomed and frowned upon the Commission's attempt to depart therefrom. There, as here, the lower Court explained and supported its holdings in a scholarly opinion in which the Supreme Court's pronouncements on the subject were recognized. But there, the Supreme Court held that the Commission could not be anchored to the traditional regulatory pattern, and reversed the lower Court.

We are aware that this Court pointed out in its opinion that it is convinced "that the allowance of a field price for the utility's own produced gas as an element in the ultimate composition of rates is not unlawful merely because it departs from the traditional rate-base method" (Opinion p. 9); and that the conventional rate-base method is not the only one available under the statute (Opinion p. 16). Nevertheless, the Court said (Opinion p. 16):

> "Furthermore, it is seen that when we refer to an 'increase' we mean an increase in the rates above those which would result from use of the conventional rate-base method. For, though we hold that method not to be the only one available under the statute, *it is essential in such a case as this that it be used as a basis of comparison.* It has been repeatedly used by the Commission, and repeatedly approved by the Courts, as a means of arriving at lawful—'just and reasonable'—rates under the Act. Unless it is con-

> tinued to be used at least *as a point of departure*, the whole experience under the Act is discarded and no anchor, as it were, is available by which to hold the terms 'just and reasonable' to some recognizable meaning." (Emphasis supplied).

Neither the Fourth Circuit in the *Hope* case nor this Court prescribed any single method as the only one available to the Commission, but both that court and this set up a specific method as a basis of comparison. Since the Supreme Court refused to require that the Commission be bound to one method in the *Hope* case, it should not be forced on the Commission in this case.

The unqualified sweep of the Supreme Court's language in the *Natural Gas Pipeline Company* and the *Hope Natural Gas Company* cases,[5] makes it clear that the Supreme Court was not limiting its opinions to cases in which a lower court might prohibit outright the use by the Commission of a specified rate-making formula, because no such case had come before the Court. And it is equally clear that the Supreme Court intended the interdiction of its opinion to embrace also cases, like those now before this Court, in which the Court restricted the Commission's freedom in performing its regulatory function by prescribing a specified rate-base method as a standard of comparison and a point of departure, for that was the issue to which the Supreme Court addressed its opinion in the *Hope* case, 320 U.S. at 600-607.

It is now settled by judicial construction that the Commission, in exercising its regulatory powers, is not anchored to any one rate formula, even as a basis of comparison or as a point of departure. That construction is as much a part of the statute as the text itself. *Douglass* v. *County of Pike (Missouri)*, 101 U.S. 677, 687 (1879), *Lindsley* v. *Natural Carbonic Gas Co.*, 220 U.S. 61, 73, (1911) and cases cited therein.

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[5] Cf. *Colorado Interstate Gas Company* v. *Federal Power Commission*, 324 U.S. 581, 601-605 (1945).

## II

### The Court Erred in Holding That Net Revenues From Extraction Operations Should be Credited to Gas Service Operating Expenses

The Court reversed the Commission's action in excluding the gasoline extraction operations for purposes of determining the cost of service for natural gas sold for resale in interstate commerce on the ground that the reason given by the Commission is unacceptable to the court, and the Commission has failed to demonstrate a basis for its conclusion that the extraction business should be treated as non-jurisdictional (pp. 20-21).[6] The Court considers that *the only justification* for excluding the gasoline operations is the fact of the fluctuating and unregulated price of the gasoline extracted (p. 18), and the Court concludes that this reason is not a valid basis for refusing to credit the gasoline revenues (p. 20).

Even if the fluctuating and unregulated price were the *only* reason given by the Commission, the Court may not substitute its judgment for that of the expert body. The Commission stated "It is our view that the rates we prescribe for the sale of natural gas for resale should not rest in part upon the fluctuating and unregulated prices of natural gasoline". It cannot be said that this reason is so devoid of rationality as to be arbitrary or capricious.

> ". . . as between two fairly conflicting views the court may not displace the Commission's choice, even though the court would justifiably have made a different choice had the matter been before it de novo. *State Corp. Com.* v. *F.P.C.*, 206 F. 2d, 690, 698 (C.A. 8, 1953).

See also *Colorado Interstate Gas Co.* v. *F.P.C.*, 209 F. 2d, 717, 724 (C.A. 10, 1953), where the Tenth Circuit held: If the Commission's findings are supported by substantial evidence, "we may *not* set them aside merely because we as triers of the facts might reach different conclusions".

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[6] References are to slip opinion of the court.

Thus, the Court has misconceived the scope of review of an FPC order and has set aside the Commission's determination simply because it reached a different conclusion from the unchallenged and factually correct subsidiary finding that gasoline prices do fluctuate.

But the Court misinterpreted the Commission's basis for excluding the gasoline extraction credits. The Court indicates that the fluctuating prices of gasoline was the *only* reason for the Commission's action *after* the Commission first determined that it was free to consider the extraction business as non-jurisdictional. The Court states that the Commission erroneously determined the extraction business was non-jurisdictional "in order to implement its policy of eliminating fluctuations in rates" (p. 19). On the contrary, the Commission's finding of non-jurisdiction over the gasoline extraction business had nothing to do with the fluctuation of gasoline prices. The Commission used the term "non-jurisdictional" in the sense that it considered the extraction business as a separate department or business in determining Panhandle's resale rates. No question of "jurisdiction" as such as involved. The Commission was addressing itself to the contention that "it is possible to operate Panhandle's system successfully without the extraction of gasoline" (R. 9774). The Commission concluded that the evidence in this record would not support a finding that the extraction process was an essential part of the business of transporting and marketing the natural gas and that "the extraction is not requisite to preparation of the gas for pipeline transportation" (R. 9775).

The point is that the question of the necessity for the extraction to make the natural gas transportable was independent of the fluctuations in price of gasoline. There was a great deal of testimony pro and con on the question of the necessity of the extraction. (R. 1231-1235; 1545-1575; 1941-1944; 5135-5147; 7228-7264; 7280-7281; 7316; 8479-8502) The Commission found, and its findings are based on substantial evidence, that under the facts here the ex-

traction was not requisite. Since the extraction was not a necessary ingredient of the natural gas business, the Commission decided to treat it as non-jurisdictional. The fluctuation in price was another reason to treat it as non-jurisdictional, but a minor reason. The important reason for excluding the gasoline operations was that they were not a necessary adjunct of the natural gas transmission business.

The Natural Gas Act does not require the Commission to credit the gasoline extraction revenues. In the case of a joint operation, such as exists here where two or more marketable products are produced together, the Commission is free to disregard the gasoline extraction operations in fixing the resale rates of natural gas. All that is required is that the gasoline bear its fair share of the costs. This the Commission did in this instance. Congress authorized the Commission, and not the courts, to exercise the requisite judgment and discretion.

Manifestly, if the costs of gasoline extraction are charged against the consumers, the revenues from gasoline sales should be credited. But this is not to say that the Commission is without discretion to completely ignore both gasoline extraction costs and gasoline sales revenues if in its judgment the consumers would not thereby be required to pay unjust and unreasonable rates. The opinion of the Court on this point denies to the Commission any discretion and assumes that the gas consumers have a legal right to pay the gasoline extraction costs and to receive credit for the gasoline revenues.

## III

**The Court Could Not Consider Sua Sponte, the Question of the Validity of the Use of the Field Price as Affected by the Lack in the Proceedings of Anything From Which the Conclusion Could be Drawn That the Increase in Rates Is No More Than Is Reasonably Necessary for the Purposes Advanced (Opinion pp. 15-16)**

Neither of the petitioners herein raised the foregoing question in its Petition for rehearing which was filed with the Commission. Neither of them objected to the Commis-

sion's use of the field price on the grounds advanced by the Court for holding such use invalid. (Opinion pp. 15-16).

The petitioner in No. 12,351, City of Detroit, Michigan, in its petition for Rehearing (R. 10702-10710) objected, in Section I (R. 10703) of its petition, to the use of the field price, but the objection was not founded on the grounds advanced by the Court for holding such use invalid.

The petitioner in No. 12,539, County of Wayne, Michigan, in its Petition for Rehearing (R. 9949-9956) objected to the use of the field price in sections V (R. 9951), VI (R. 9952), VII (R. 9952), VIII (R. 9952), VIII-A (R. 9953), VIII-B (R. 9953), VIII-C (R. 9953), X (R. 9954), XI (R. 9954), and XII (R. 9955), of its petition, but none of its objections was founded on the grounds advanced by the Court for holding such use invalid.

Section 19 (a)[7] of the Act gives to any party aggrieved by an order of the Commission the right to apply for rehearing and then provides, in pertinent part that:

> "The application for rehearing shall set forth specifically the ground or grounds upon which such application is based."

Section 19 (b) provides for court review of the Commission's orders and then limits the court's jurisdiction to review such orders, as follows:

> "No objection to the order of the Commission shall be considered by the Court unless such objection shall have been urged before the Commission in the application for rehearing unless there is reasonable ground for failure so to do."

The record does not contain any explanation by either of the petitioners of its failure to urge before the Commission the objection on which the Court based its holding that the Commission's use of the field price was invalid.

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[7] Sections 19 (a) and 19 (b) of the Act are set out in Appendix A.

It is immaterial whether such objection was raised by either of the petitioners in the proceedings in this Court or not because it is now settled that, not having raised such objection in their applications for rehearing before the Commission, they are precluded from attacking the Commission's order on such ground in this Court. *Panhandle Eastern Pipe Line Co.* v. *Federal Power Commission*, 324 U.S. 635, 649, 650-651.

The question now before the Court is whether, on a petition to review the Commission's rate order, the Court may consider, *sua sponte*, an objection which was not urged before the Commission in the application for rehearing.

That question was answered in the negative by the Supreme Court in *Federal Power Commission* v. *Colorado Interstate Gas Co.*, 348 U.S. 492, 498 (1955). The Court said (pp. 498-499):

> "As the court is thus expressly precluded from considering an objection when, without prior application to the Commission, that objection is presented to the court by the party directly aggrieved, it cannot be assumed that Congress intended to *permit* the same court to consider the same objection, under the same circumstances, sua sponte, merely because the objection was *not* presented to the court by the party aggrieved. Section 19 (b) reflects the policy that a party must exhaust its administrative remedies before seeking judicial review. To allow a Court of Appeals to intervene here on its own motion would seriously undermine the purpose of the explicit requirements of § 19 (b) that objections must first come before the Commission."

The Court set forth further reasons for its decision, *Id.* 501:

> "The necessity for prior administrative consideration of an issue is apparent where, as here, its decision calls for the application of technical knowledge and experience, not usually possessed by judges. The Federal Power Commission is an administrative agency

> the decisions of which involve those difficult problems of policy, accounting, economics and special knowledge that go into public utility rate making. For reviewing a rate made by the Federal Power Commission, the Court of Appeals has no inherent suitability comparable to that which it has for reviewing the judicial decisions made by a United States District Court."

Orderly procedure and good administration require that a party exhaust his administrative remedy before seeking court review of an order of the Commission in order to give the Commission an opportunity for correction of the order complained of.

In *United States* v. *Tucker Truck Lines*, 344 U.S. 33, 36-37 (1952), the Supreme Court said:

> "We have recognized in more than a few decisions, and Congress has recognized in more than a few statutes, that orderly procedure and good administration require that objections to the proceedings of an administrative agency be made while it has opportunity for correction in order to raise issues reviewable by the courts." (citing cases.)

In considering *sua sponte* an objection not raised by either of the Petitioners in its Petition for Rehearing, the Court has exceeded its authority to review the Commission's order.

In *Unemployment Compensation Commission of Alaska* v. *Aragon*, 329 U.S. 143, 155 (1946), the Supreme Court said:

> "The responsibility of applying the statutory provisions to the facts of the particular case was given in the first instance to the Commission. A reviewing court usurps the agency's function when it sets aside the administrative determination upon a ground not theretofore presented and deprives the Commission of an opportunity to consider the matter, make its ruling, and state the reasons for its action."

## IV

### The Court Erred in Setting Aside the Commission's Rate Order

The Commission's rate order is presumed to be valid. The Petitioners had the burden of showing that the order is invalid because it is unjust and unreasonable in its consequences. They have not met that burden of proof.

In *Federal Power Commission* v. *Hope Natural Gas Co., supra*, at p. 602, the Supreme Court said:

> "Moreover, the Commission's order does not become suspect by reason of the fact that it is challenged. It is the product of expert judgment *which carries a presumption of validity.* And *he who would upset the rate order under the Act carries the heavy burden of making a convincing showing that it is unjust and unreasonable in its consequences.*" (Emphasis supplied).

The Court has not held that the rates fixed by the Commission in this case are unjust or unreasonable nor that they are inconsistent in any respect with statutory and constitutional requirements. It follows that the Court is without authority to set aside the Commission's order.

## CONCLUSION

Having demonstrated to the Court that the Court's prescription of the prudent-investment rate base, as the standard of comparison and "point of departure" for the Commission's natural gas rate-making, contravenes the congressional intent in the Natural Gas Act and Supreme Court decisions; that the Court erred in holding that net revenues from extraction operations should be credited to gas service operating expenses; that the Court extended its review of the Commission's order beyond the authority granted in the Act; and that the Court erred in setting aside the Commission's rate order; the Respondent respectfully submits that, for each of the reasons set forth herein, the Petition for Rehearing should be granted, that the Court's opinion of December 15, 1955, and judgment in the cases herein

should be vacated, and that the Commission's rate order, issued April 15, 1954, with the Commission's Opinion No. 269, should be reinstated and affirmed.

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**Certificate of Counsel**

I, Willard W. Gatchell, General Counsel of the Federal Power Commission and its counsel in this case, do hereby certify that the foregoing Petition for Rehearing is presented in good faith and not for delay.

WILLARD W. GATCHELL,
*General Counsel*

JANUARY 31, 1956

## APPENDIX A

### Natural Gas Act—Pertinent Sections

June 21, 1938, c. 556, 52 Stat. 821; 15 U.S.C. 717 et seq.
February 7, 1942, c. 49, 56 Stat. 83; 15 U.S.C. 717 f(e-g).
July 25, 1947, c. 333, 61 Stat. 459; 15 U.S.C. 717 f(h).
March 27, 1954, c. 115, 68 Stat. 36; 15 U.S.C. 717 (e).

REHEARING; COURT REVIEW OF ORDERS

SEC. 19 (a) Any person, State, municipality, or State commission aggrieved by an order issued by the Commission in a proceeding under this act to which such person, State, municipality, or State commission is a party may apply for a rehearing within thirty days after the issuance of such order. The application for rehearing shall set forth specifically the ground or grounds upon which such application is based. Upon such application the Commission shall have power to grant or deny rehearing or to abrogate or modify its order without further hearing. Unless the Commission acts upon the application for rehearing within thirty days after it is filed, such application may be deemed to have been denied. No proceeding to review any order of the Commission shall be brought by any person unless such person shall have made application to the Commission for a rehearing thereon.

(b) Any party to a proceeding under this act *aggrieved* by an order issued by the Commission in such proceeding may obtain a review of such order in the circuit court of appeals of the United States for any circuit wherein the natural-gas company to which the order relates is located or has its principal place of business, or in the United States Court of Appeals for the District of Columbia, by filing in such court, within sixty days after the order of the Commission upon the application for rehearing, a written petition praying that the order of the Commission be modified or set aside in whole or in part. A copy of such petition shall forthwith be served upon any member of the Commission and thereupon the Commission shall certify and file with the court a transcript of the record upon which the order complained of was entered. Upon the filing of such

transcript such court shall have exclusive jurisdiction to affirm, modify, or set aside such order in whole or in part. No objection to the order of the Commission shall be considered by the court unless such objection shall have been urged before the Commission in the application for rehearing unless there is reasonable ground for failure so to do. The finding of the Commission as to the facts, if supported by substantial evidence, shall be conclusive. If any party shall apply to the court for leave to adduce additional evidence, and shall show to the satisfaction of the court that such additional evidence is material and that there were reasonable grounds for failure to adduce such evidence in the proceedings before the Commission, the court may order such additional evidence to be taken before the Commission and to be adduced upon the hearing in such manner and upon such terms and conditions as to the court may seem proper. The Commission may modify its findings as to the facts by reason of the additional evidence so taken, and it shall file with the court such modified or new findings, which if supported by substantial evidence, shall be conclusive, and its recommendation, if any, for the modification or setting aside of the original order. The judgment and decree of the court, affirming, modifying, or setting aside, in whole or in part, any such order of the Commission, shall be final, subject to review by the Supreme Court of the United States upon certiorari or certification as provided in sections 239 and 240 of the Judicial Code, as amended (U. S. C., title 28, secs. 346 and 347).

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# INDEX


| | Page |
|---|---|
| Opinions below | 1 |
| Jurisdiction | 2 |
| Questions presented | 2 |
| Statute involved | 3 |
| Statement | 3 |
| Reasons for granting the writ: | |
| The field price method is within the statute | 7 |
| Gasoline extraction operations were a separate business | 14 |
| Lower court's action *sua sponte* contravenes this Court's decision | 21 |
| Conclusion | 24 |
| Appendix | 25 |


## CITATIONS


| | |
|---|---|
| Cases: | |
| *American Telephone & Telegraph Co.* v. *United States*, 299 U. S. 232 | 20 |
| *Colorado Interstate Gas Co.* v. *Federal Power Commission*, 324 U. S. 581 | 5, 6, 10, 20 |
| *Federal Power Commission* v. *Colorado Interstate Gas Company*, 348 U. S. 492 | 21 |
| *Federal Power Commission* v. *Hope Natural Gas Co.*, 320 U. S. 591 | 5, 10, 12, 20 |
| *Federal Power Commission* v. *Natural Gas Pipeline Co.*, 315 U. S. 575 | 5, 10 |
| *Montana-Dakota Utilities Company* v. *Northwestern Public Service Company*, 341 U. S. 246 | 14 |
| *Panhandle Eastern Pipe Line Co.* v. *Federal Power Commission*, 324 U. S. 635 | 6, 10 |
| *Smyth* v. *Ames*, 169 U. S. 466 | 12 |
| *Terminal Railroad Association* v. *United States*, 266 U. S. 17 | 11 |




387072—56——1

## STATUTE

Page

Natural Gas Act, 52 Stat. 821–833, 15 U. S. C. Section 717 et. seq.:

Section 4 ..... 4, 9, 27, 38
Section 4 (a) ..... 27, 32, 33, 34, 35, 36
Section 4 (e) ..... 4, 27
Section 5 (a) ..... 4, 9, 27, 33, 34, 35, 38
Section 7 ..... 38, 39
Section 19 ..... 21, 22, 23
Section 19 (b) ..... 2, 21, 23

# In the Supreme Court of the United States

OCTOBER TERM, 1955

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No. ——

FEDERAL POWER COMMISSION, PETITIONER

*v.*

CITY OF DETROIT, MICHIGAN, AND COUNTY OF WAYNE, MICHIGAN

---

*PETITION FOR A WRIT OF CERTIORARI TO THE UNITED STATES COURT OF APPEALS FOR THE DISTRICT OF COLUMBIA CIRCUIT*

---

The Federal Power Commission prays that a writ of certiorari issue to review the judgment of the United States Court of Appeals for the District of Columbia Circuit entered in the above-entitled cases on December 15, 1955. Petition for rehearing was denied February 28, 1956.

## OPINIONS BELOW

The opinion of the Court of Appeals (App. 25)[1] is reported at 230 F. 2d 810. The opinion on denial of rehearing is not reported but is printed in Appendix, pp. 56–57. The pertinent opinion and order of the Federal Power Commission are

[1] "App." refers to the appendix to this petition.

printed in the Joint Appendix, pp. 9726–9943, and are reported at 3 PUR 3d 396.

**JURISDICTION**

The judgment of the Court of Appeals was entered on December 15, 1955 (App. 54–55). Petition for rehearing was denied February 28, 1956 (App. 56–57). Jurisdiction is conferred upon this Court by 28 U. S. C. § 1254 (1) and section 19 (b) of the Natural Gas Act, June 21, 1938, 52 Stat. 831; 15 U. S. C. 717r (b).

**QUESTIONS PRESENTED**

1. Should the Federal Power Commission, in fixing the rates of a natural gas pipeline company under the Natural Gas Act, be required to use the net investment, rate-base formula either as "a basis of comparison" or as "a point of departure" (App. 43) when in setting rates the Commission includes the field price formula of the pipeline company's own produced gas in the cost of service and excludes that company's production and gathering properties from the rate base?

2. May court review of the Commission's order extend beyond the authority for judicial review granted in the Natural Gas Act and consider *sua sponte* the question of the validity of the use of field price as affected by a purported lack in the proceedings of anything from which a conclusion could be drawn by a court that the increase in

rates here is no more than is reasonably necessary for the purposes advanced?

3. Is there any basis for judicial interference with the discretion of the Commission to require that net revenues from the gasoline-extraction operations of Panhandle be credited to gas service operating expenses when the Commission was unwilling to find and did not find that the gasoline-extraction operations were essential to the transportation and sale of natural gas in interstate commerce?

## STATUTE INVOLVED

The pertinent provisions of the Natural Gas Act, June 21, 1938, c. 556, 52 Stat. 821, 15 U. S. C. § 717 *et seq.* are set out in Appendix, pp. 58–63.

## STATEMENT

Upon petitions filed by the City of Detroit and County of Wayne, Michigan, the lower court set aside the Commission's orders of April 15, 1954 and June 7, 1954 and remanded the cases to the Commission for further proceedings. The order of April 15, 1954 prescribed, effective May 1, 1954, certain rates and charges by Panhandle Eastern Pipe Line Company for natural gas which it sold in interstate commerce for resale. The order of June 7, 1954 denied a rehearing. Panhandle is a "natural-gas company" within the meaning of the Natural Gas Act, 52 Stat. 822 (1938), 15 U. S. C. § 717, engaged in the trans-

portation of natural gas in interstate commerce and in its sale in such commerce for resale. Its rates and charges accordingly are within the jurisdiction of the Commission and of this Court on review of the Commission's order.

The Commission instituted an investigation of Panhandle's rates under section 5 (a) of the Act and before the investigation was completed Panhandle filed a revised tariff under section 4 of the Act proposing increased rates aggregating approximately $21,400,000. This increase was suspended by the Commission but later was placed in effect as of February 20, 1952 under bond furnished in accordance with section 4 (e) of the Act. After hearings, waiver of the intermediate decision procedure and oral argument, the Commission, on April 15, 1954, issued its Opinion No. 269 and order here under review permitting an increase, effective May 1, 1954, of approximately $12,778,000 instead of $21,400,000 sought by Panhandle.[2] The order also directed reopening of the record for the limited purpose of securing evidence from which the Commission could determine the amount of revenue collected by Panhandle under bond in excess of the increase al-

[2] As the Commission noted (R. 9837), Panhandle's proposed increase of $21,400,000 is not strictly comparable with the $12,778,000 allowed because the Commission used a higher volume of gas for the test year. If the volumes of gas on which the $21,400,000 increase was based were increased to the volumes on which the $12,778,000 is computed, the proposed increase would be approximately $22,700,000 (R. 9838).

lowed, which excess will have to be refunded by Panhandle with 6 percent interest.

Panhandle owns and operates a natural gas pipe line system through which it transports gas from Texas, Oklahoma and Kansas to Michigan and intervening States. It produces natural gas in the Panhandle-Hugoton Fields in Texas, Oklahoma and Kansas and purchases gas from other sources, including its subsidiary, Trunkline Gas Supply Company. For the year 1952, the test year used by the Commission, 22.6 percent of its total gas supply available for interstate transmission and sale came from its own production; 25.3 percent was purchased from Trunkline, its subsidiary, and the balance, 52.1 percent, was purchased from others. Out of a total sales volume of 327,520,405 Mcf during the test year 1952, the jurisdictional sales in interstate commerce for resale amounted to 275,052,339 Mcf of which 73,204,677 Mcf was from Panhandle's own production.

In its order under review the Commission used with one exception, the "prudent investment" rate-base method for establishing the rates of Panhandle which in the Commission's judgment would be just and reasonable, a method which has had repeated approval by this Court and was not brought into question here. *Federal Power Commission* v. *Natural Gas Pipeline Co.* 315 U. S. 575; *Federal Power Commission* v. *Hope Natural Gas Co.* 320 U. S. 591; *Colorado Interstate Gas*

*Co.* v. *Federal Power Commission* 324 U. S. 581; *Panhandle Eastern Pipe Line Co.* v. *Federal Power Commission,* 324 U. S. 635. The single exception concerned the return to be allowed for Panhandle's own production operations. The Commission computed a "field price" for the gas obtained by Panhandle from this source, based upon "the weighted average arm's length prices" established for similar gas in sales by other companies. The Commission then multiplied Panhandle's production by this "field price" and included the result, $5,476,804, in Panhandle's operating expenses as part of the amount to be recovered through the rates (R. 9818). At the same time the Commission excluded from the rate base the cost of the properties which produce this gas and excluded from recoverable operating expense the cost of producing it (R. 9745, 9815).

The Commission's order of April 15, 1954 also found Panhandle's investment in its average gas plant in service, excluding Panhandle's own gas production properties and products extraction plants, from which investment it deducted accrued depreciation, contribution in aid of construction, and working capital, to arrive at a rate base of $148,609,012 (R. 9816) on which it allowed an annual rate of return of 5¾ percent (R. 9813). The cost of service for the jurisdictional business was found to be $67,579,207. This amount contrasted to the revenues under the rates

in effect prior to Panhandle's proposed rate increase showed a deficiency in revenues of $12,778,864, which is the amount of the increase prescribed in the Commission's order (R. 9837), allowing Panhandle to recover all costs of service and operating expenses including taxes, depreciation, depletion, plus a fair return on the rate base.

The City of Detroit and the County of Wayne, petitioners below and interveners before the Commission, attack the rates prescribed by the Commission in the order of April 15, 1954 on the ground that the Commission erred in determining Panhandle's cost of service in the following particulars, among others: (1) The use by the Commission of a field price formula to accord to Panhandle's own produced gas the same value as the gas it purchases from others; and (2) the exclusion of Panhandle's gasoline extraction business in fixing the rates for the sale of natural gas. The lower court held that the Commission erred in these two particulars but otherwise affirmed the order. The separate petitions filed by the City of Detroit and the County of Wayne were consolidated by the court below, the issues being substantially the same.

## REASONS FOR GRANTING THE WRIT

### THE FIELD PRICE METHOD IS WITHIN THE STATUTE

If, as the Commission found, it is necessary to encourage interstate pipe line companies in

the exploration and development of gas resources (R. 9768–9769), the court said that the amount allowed for the purpose should not be more than is required in the public interest and by reviewing the rates here found by the Commission to be just and reasonable the court delegated to itself a determination of what rates would be lawful. Recognizing the reasons advanced by the Commission for using the field price of natural gas as a commodity in determining the operating expenses to be allowed under the Natural Gas Act, the court held that the field price method does not under the circumstances of this case vindicate the rates prescribed by the Commission, for the court could find nothing in the record from which it could draw a conclusion that the increase in rates under the field price method was no more than was reasonably necessary for the purpose advanced (App. 42).

If the court predicated its reversal of the field price formula portion of the Commission's order on the failure of the Commission to make requisite findings or upon what it says is the absence of evidence to support findings, very little national importance would attach to the decision. However, the court may intend a broader application of its holding than mere lack of findings or evidence, for it goes on to say that while the "conventional rate base-method" is not the only one available under the statute, "it is essential in such a case as this that it be used as a basis

of comparison" or at least "as a point of departure" (App. 43).

There is no actual relationship between the cost of gas producing properties and the field prices of natural gas, for in this very proceeding the Commission pointed out that under the net investment rate-base method the production operations of Panhandle would give to its own produced gas less than nothing at the wellhead for each Mcf of the natural gas produced and sold as compared with the average 7.7457 cents per Mcf estimated to be paid by Panhandle for gas purchased from others and the weighted average price of 8.4398 cents per Mcf prevailing in the same fields (R. 9745–9747, 9763–9764).

Aside from the court's attempt to relate factors which have no necessary economic relationship, the fundamental question is whether the Commission or the reviewing courts shall determine what formula must be used by the Commission in reviewing the rates and charges filed under the Act and in fixing just and reasonable rates under sections 4 and 5 (a). When the lower court prescribed the net investment rate-base method as the standard of justness and reasonableness to be used, it acted in direct conflict with the decisions of this Court previously upholding the prerogative of the Commission, within the ambit of its statutory authority, to select a rate formula free from judicial interference, so long as the rates are not shown by the evidence to be either

confiscatory on the one end or unreasonably high on the other. *Federal Power Commission* v. *Natural Gas Pipe Line Co., supra; Federal Power Commission* v. *Hope Natural Gas Co., supra; Colorado Interstate Gas Co.* v. *Federal Power Commission, supra; Panhandle Eastern Pipe Line Co.* v. *Federal Power Commission, supra.*

The court explains its reference to the invalidity of the Commission's use of the field price formula here as not being properly related to the public interest by the evidence and findings, for the court says that "the evidence and findings must show that the increase in rates thus caused is not more than is reasonably necessary for the purposes advanced for any increase." In amplification of its reference to an increase, the court says (App. 42–43):

> Furthermore, it is seen that when we refer to an "increase" we mean an increase in the rates above those which would result from use of the conventional rate-base method. For, though we hold that method not to be the only one available under the statute, it is essential in such a case as this that it be used as a basis of comparison. It has been repeatedly used by the Commission, and repeatedly approved by the courts, as a means of arriving at lawful—"just and reasonable"—rates under the Act. Unless it is continued to be used at least as a point of departure, the whole experience under the Act is discarded and no

> anchor, as it were, is available by which to hold the terms "just and reasonable" to some recognizable meaning.

The sum and substance of the court's holding, therefore, is that the Commission's use of the field price method in valuing Panhandle's produced gas is invalid because the evidence and findings do not show that the resultant higher increase in rates *over the increase that would have resulted from the use of the rate-base method* is needed for the purpose advanced and is the minimum amount that will accomplish its purpose (App. 40–42).

If the lower court means to require adherence by the Commission to the rate-base formula "as a basis of comparison" or "as a point of departure" the court necessarily is running contra to the prior decisions of this Court. Flexibility in the selection of formula and freedom to select the formula best calculated to serve the public interest are the essence of the rate making function and indeed this Court has been zealous to protect regulatory agencies in this basic prerogative. Cf. *Terminal Railroad Association* v. *United States* (266 U. S. 17). Indeed it might be appropriate to ask in this connection why, when the lower court reached the conclusion that some standard other than field price is necessary as a basis of comparison, it did not return to the reproduction-cost standard which was adhered to for more than

forty years, from *Smyth* v. *Ames,* 169 U. S. 466 (1898) up to the *Hope* decision in 1944 (320 U. S. 591).

The amount found by the Commission as the rate base is uncontested, as is also the rate of return which the Commission allowed thereon. Moreover, the lower court accepted "as supported by substantial evidence, the findings of the Commission regarding the weighted average arm's length prices paid at the wellhead" (App. 31–32).

Both the lower court and the Commission recognized that the use of the field price formula was a departure from prior Commission practice but the court directed its attention first to the question of whether "the larger amount required to be paid by consumers * * * than would be charged were the rate-base method followed throughout removes the prescribed rates from a 'just and reasonable' category" (App. 32). In other words, the court did not consider the field price method on its own intrinsic worth but related it to another formula. We respectfully suggest that if the field price formula is proper—and its suitability was accepted by the lower court—it is proper on its own merits and does not become suspect because it produces larger amounts than would be produced by some other method. By relating the field price to the rate base method so that "larger amounts" are said to

be carried in the prescribed rates the court appears to be inconsistent with its holding that the Commission is not required to set rates always at the very brink of confiscation (App. 35). At no place in its opinion does the court expressly find the rates fixed by the Commission to be unjust or unreasonable, and absent such a finding the Commission's order should have been affirmed.

If pipeline companies are to be given the economic incentive to accomplish the objectives which the lower court approves as stated by the Commission, then they may be given the field price for their own produced gas, not something less or something more.

Moreover, when the lower court requires that the evidence and findings show that the increase in rates resulting from the use of the field-price method is needed to encourage exploration and development, or ownership by pipeline companies of their own production facilities, and is no more than is needed for those purposes (App. 40), it is in fact requiring the Commission to fix the lowest reasonable rates. Any doubt on that point should be removed by the court's further statement (App. 40–41):

> Of course the rate increase attributable to producing properties might have a tendency to encourage their ownership, and perhaps also the development of new sources of production, as an even greater

increase also might do. But the question is whether a lesser amount would suffice.

The court's requirement of the lowest possible reasonable rate is contrary to the Supreme Court's interpretation of statutory reasonableness as "an area rather than a pinpoint" allowing "* * * a substantial spread between what is unreasonable because too low and what is unreasonable because too high". *Montana-Dakota Utilities Company* v. *Northwestern Public Service Company,* 341 U. S. 246, 251.

In this connection, if, as the Commission found, the uncontroverted evidence shows a necessity for the allowance of some amount to encourage this pipeline company to engage in exploration and development of natural gas resources, and there is no evidence to show that the amount allowed by the Commission in using the field prices for Panhandle-produced gas was excessive or unreasonable, a correct result was reached which should not be disturbed by a court. *Montana-Dakota Utilities Co., supra.,* at 249–250.

## GASOLINE EXTRACTION OPERATIONS HERE WERE A SEPARATE BUSINESS

In this case, the Commission, for reasons that were misinterpreted by the court below, departed from its previous practice in another respect also, namely in the treatment of revenues derived from the extraction and sale of gasoline from the gas and the expenses connected with such extraction

and sale. The gasoline extraction is simply the removal of any gasoline which is contained in the wet gas stream (raw gas) as it comes from the ground. After the heavier hydrocarbons are extracted, the remainder is called residue or dry gas and is the natural gas that is transported and sold, the rates for which were fixed in these proceedings.

In several previous cases, the Commission had included in the rate base the net investment in the extraction facilities and, in the cost of service, the expenses incurred in extracting and selling the gasoline, and had credited the revenues derived from the extraction operations to the cost of service. In those cases the extraction process was found to be necessary to make the natural gas marketable and transportable and was an essential part of the business of transporting and marketing natural gas (R. 9775).

In this case, however, Panhandle contended that the extraction from its gas stream of gasoline and other liquid hydrocarbons is a separate business carried on for profit and therefore, the net revenues derived therefrom should not be credited to the cost of service (R. 9773). There was uncontradicted testimony that Panhandle's gasoline extraction operations were not necessary to render the gas transportable and marketable (R. 1232, 1235, 1571, 1574–1575, 1881–1882). The Commission accordingly treated Panhandle's

387072—56— 3

gasoline extraction operations as a separate business beyond its jurisdiction because it could not find that such operations were essential to the transportation and sale of natural gas. It was also the Commission's incidental view that gas rates should not rest in part upon the fluctuating and unregulated prices of gasoline and other hydrocarbons (R. 9774–9775).

Instead of crediting net revenues from extraction operations to the cost of service and including the net investment in extraction facilities in the rate base, the Commission, over the objection of petitioners below, permitted Panhandle to retain the gasoline revenues and stand the cost of extraction operations and it excluded the net investment in extraction facilities from the rate base.

In the test year 1952, the net revenues from Panhandle's extraction operations amounted to $1,982,925 (R. 9773). Expenses which were jointly incurred in the purchase, production, gathering and transportation of the raw gas from the wellmouth or points of purchase to the extraction plants were allocated to the gasoline and the dry gas by the Btu method, an allocation which is not in issue here (R. 9775–9776). A credit of $591,710 was made to the cost of service to cover the loss in heating value of the natural gas during the course of processing in the extraction plant (R. 9776–9777, 9820).

The question as to whether the Commission may decide how expenses of extracting gasoline from natural gas and how revenues from the sale of extracted gasoline are to be handled, in the absence of any condition or agreement binding upon the Commission and the natural gas company, is presented to this Court for the first time. In this case the lower court reversed the Commission's action in excluding gasoline extraction operations in the determination of Panhandle's cost of service upon the ground that the reason given by the Commission is unacceptable to the court and the Commission has failed to demonstrate a basis for its conclusion that the extraction business should be treated as non-jurisdictional (App. 48).

The court misinterpreted the Commission's reasons for excluding in this case gasoline extraction expenses and revenues from the cost of service contrary to the practice it had followed in several previous cases. In the court's view, the Commission based its actions solely on the ground that natural gas rates "* * * should not rest in part upon fluctuating and unregulated prices of natural gasoline and other liquid hydrocarbons" (App. 45), and the court concluded that this reason is not a valid basis for refusing to credit revenues from gasoline sales to Panhandle's cost of service (App. 47–48).

While it is true that the Commission took into consideration the undesirability of natural gas

rates being affected by fluctuations in the price of gasoline, that was only a minor consideration and was not the principal reason for the Commission's determination of this question. The principal reason was that, whereas in other cases there was evidence that extraction operations were necessary to make the natural gas marketable and transportable, the evidence in this case would not support a similar finding with respect to Panhandle's extraction operations (R. 9775), and since Panhandle engaged in extraction and sale of gasoline from natural gas as a separate business carried on for profit (R. 9773), the Commission concluded that, to the extent that such extraction is not requisite to preparation of the gas for pipe-line transportation, such extraction operations should be treated as non-jurisdictional (R. 9775).

That the Commission's position on this question is not without substantial foundation is indicated by Circuit Judge Danaher who, dissenting in part from the order of the lower court denying the Commission's petition for re-hearing, said (App. 57):

> When these cases were before us I had certain misgivings. Apart from my feeling that, in principle, natural gas should be regarded as a commodity and hence a competing fuel, I am concerned about the nonjurisdictional gasoline sales. I think the Commission might well have convinced

> us that it had a proper basis for excluding the gasoline extraction credits. The petitions for rehearing have bestirred my doubts to the extent of leading me to believe that we should rehear the parties on this point, and I would have granted re-hearing accordingly.

The problem here involved is essentially one of allocating the expenses attributable to the handling and sale of gasoline extracted from natural gas and the revenues derived from such sales. No question is raised regarding the method that was used to allocate costs that were jointly incurred in the production of natural gas and gasoline. Congress did not write into the Natural Gas Act any formula for determining how those expenses and revenues should be allocated nor did the court supply any such formula; it merely rejected the formula followed by the Commission.

The Natural Gas Act does not require the Commission to credit the gasoline extraction revenues. In the case of a joint operation, such as exists here where two or more marketable products are produced together, the Commission is free to disregard the gasoline extraction operations in fixing the resale rates of natural gas. All that is required is that the gasoline bear its fair share of the costs. This the Commission did in this instance. Congress authorized the Commission, and not the courts, to exercise the requisite judg-

ment and discretion. In its decision the court exceeded the bounds of judicial review in that it did not limit its review to keeping the Commission within the bounds which Congress has created. *Colorado Interstate Gas Company* v. *Federal Power Commission*, 324 U. S. 581, 589.

Even if the fluctuating and unregulated price were the *only* reason given by the Commission, a court may not substitute its judgment for that of the expert body. The Commission stated "It is our view that the rates we prescribe for the sale of natural gas for resale should not rest in part upon the fluctuating and unregulated prices of natural gasoline" (R. 9774). I cannot be said that this reason is so devoid of rationality as to be arbitrary or capricious.

Apart from the requirements of judicial review, it is not for a court to advise the Commission how to discharge its functions. *Federal Power Commission* v. *Hope Natural Gas Company*, 320 U. S. at 617–618. Nor may a court substitute its own opinion or discretion for that of the Commission. *American Telephone & Telegraph Co.* v. *United States*, 299 U. S. 232, 236.

Manifestly, if the costs of gasoline extraction are charged against the consumers, the revenues from gasoline sales should be credited. But this is not to say that the Commission is without discretion to completely ignore both gasoline ex-

traction costs and gasoline sale revenues if in its judgment the consumers would not thereby be required to pay unjust and unreasonable rates. The opinion of the Court on this point denies to the Commission any discretion and assumes that the gas consumers have a legal right to pay the gasoline extraction costs and to receive credit for the gasoline revenues.

LOWER COURT'S ACTION SUA SPONTE CONTRAVENES THIS COURT'S DECISION

The Court of Appeals based its decision, in part, upon an objection which it considered *sua sponte* and which had not been urged before the Commission in an application for rehearing as prescribed section 19 of the Natural Gas Act. In so doing, it acted contrary to the holding of this Court in *Federal Power Commission* v. *Colorado Interstate Gas Company,* 348 U. S. 492, 498–499 (1955), in which this Court held that a lower court is precluded by section 19 (b) of the Act from considering any objection to an order of the Commission unless the objection shall have been urged before the Commission in the application for rehearing irrespective of whether the objection was presented to the court by the party aggrieved or was considered by the court *sua sponte.*

The lower court based its decision, in part, upon its holding that the evidence and findings

did not show that the increase in rates resulting from the use of field prices of natural gas in valuing Panhandle-produced gas was needed and was no more than what was needed for the purposes advanced in justification of the increase (App. 40, 41).

Neither of the petitioners below, in its application for rehearing, objected to the Commission's use of the average field price on the ground advanced by the lower court for holding such use invalid. Although both of the petitioners below in their applications for rehearing objected to the use of the field price, none of the objections was founded on the ground advanced by the lower court for holding such use invalid. Therefore, a condition precedent to a court review of the Commission's order under section 19 was not fulfilled and the lower court could not consider *sua sponte* the objection that the evidence and findings were inadequate.

The mere fact that petitioners below objected to the use of the field price does not *per se* validate the lower court's decision because the court did not base its decision upon any of the grounds advanced by those petitioners in support of their objections. The reasons for an objection are an essential part of the objection, for without reasons an objection is hollow, uniformative and without substance. In order that the Commis-

sion be informed of the grounds to be relied on and that the purpose of section 19 of the Act be fully realized, it is necessary that the grounds of or reasons for an objection be given together with the fact of objection. Moreover, for the lower court's reversal to be valid, it must rest upon grounds or reasons originally given as objections to the Commission, and this was not done here, especially in such a fundamental point as that relied upon by the court below.

The plain purpose of section 19 is to give the Commission an opportunity to review and rule upon an objection which is to be relied upon on review, and that purpose would be nullified if a court were permitted to predicate its decision upon grounds which were not advanced in the application for rehearing.

It follows that since the reviewing court in this case rests its decision upon a reason different from any advanced by the petitioners below in their applications for rehearing there is no compliance with the Congressional intent, as clearly stated in section 19 (b), that:

> No objection to the order of the Commission shall be considered by the Court unless such objection shall have been urged before the Commission in the application for rehearing unless there is reasonable ground for failure so to do.

387072—56——4

## CONCLUSION

For the foregoing reasons this petition for a writ of certiorari should be granted.

Respectfully submitted,

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*Counsel for Petitioner,*
*Federal Power Commission,*
*Washington 25, D. C.*

MAY 1956.

I hereby authorize the filing of the foregoing petition for a writ of certiorari.

SIMON E. SOBELOFF,
*Solicitor General.*

# APPENDIX

United States Court of Appeals for the District of Columbia Circuit

No. 12351

CITY OF DETROIT, MICHIGAN, A MUNICIPAL CORPORATION, PETITIONER

*v.*

FEDERAL POWER COMMISSION, RESPONDENT
PANHANDLE EASTERN PIPE LINE COMPANY, INTERVENOR

No. 12359

COUNTY OF WAYNE, MICHIGAN, A MICHIGAN CORPORATION AND BODY POLITIC, PETITIONER

*v.*

FEDERAL POWER COMMISSION, RESPONDENT
PANHANDLE EASTERN PIPE LINE COMPANY, INTERVENOR

On Petitions for Review of Order of the Federal Power Commission

Decided December 15, 1955

*Mr. Charles S. Rhyne,* with whom *Messrs. James H. Lee,* Assistant Corporation Counsel, Public Utilities, City of Detroit, *Eugene F. Mullin, Jr.,* and *J. Parker Connor* were on the brief, for petitioner in No. 12351.

*Mr. Leonard Simons,* of the bar of the Supreme Court of Michigan, *pro hac vice,* by special leave

of Court, with whom *Mr. Harry A. Bowen* was on the brief, for petitioner in No. 12359.

*Mr. Willard W. Gatchell,* General Counsel, Federal Power Commission, and *Mr. Jacob Goldberg,* Attorney, Federal Power Commission, of the bar of the Supreme Judicial Court of Massachusetts, *pro hac vice,* by special leave of Court, with whom *Mr. Lambert McAllister,* Assistant General Counsel, Federal Power Commission, was on the brief, for respondent in both cases.

*Messrs. William E. Miller* and *Harry S. Littman* for intervenor in both cases. *Mr. Raymond N. Shibley* also entered an appearance for intervenor in both cases.

Before FAHY, DANAHER and BASTIAN, Circuit Judges.

FAHY, *Circuit Judge*: The City of Detroit, in No. 12351, and the County of Wayne, Michigan, in No. 12359, petition us to review and set aside orders of the Federal Power Commission issued April 15, 1954, and June 7, 1954.[1] Panhandle Eastern Pipe Line Company is an intervenor in both cases. This court consolidated the two cases by an order of October 1, 1954. The Commission's order of April 15, 1954, prescribed, effective May 1, 1954, certain rates and charges for the sale by Panhandle Eastern Pipe Line Company of natural gas in interstate commerce for resale. The order of June 7, 1954, denied a rehearing. The Commission found the rates and charges prescribed to be "just and reasonable"

[1] The review petitions are filed in this court under § 19 (b) of the Natural Gas Act, 52 Stat. 831 (1938), 15 U. S. C. § 717r (b) (1952).

within the meaning of section 4 (a) of the Natural Gas Act, 52 Stat. 822 (1938), 15 U. S. C. § 717c (a) (1952). Panhandle is a "natural-gas company," that is, it is engaged in the transportation of natural gas in interstate commerce and in its sale in such commerce for resale. Its rates and charges accordingly are within the jurisdiction of the Commission, and of this court on review of the Commission's order. See note 1 *supra,* and section 2 (6) of the Natural Gas Act, 52 Stat. 822 (1938), 15 U. S. C. § 717a (6) (1952).

The Commission determined the rates and charges in the following circumstances: Pursuant to section 5 (a) of the Act it ordered an investigation of Panhandle's rates. Pursuant to section 4 Panhandle subsequently filed a revised tariff proposing increased rates aggregating approximately $21,400,000. The Commission suspended this proposed increase, but later permitted it to become effective as of February 20, 1952, under a bond furnished in compliance with section 4 (e). Upon conclusion of hearings on the tariff and related matters the Commission on April 15, 1954 issued its order now under review. It prescribed rates which permit an increase, effective May 1, 1954, of approximately $12,780,000 instead of the $21,400,000 sought by Panhandle. The order also directed that the record be reopened for the limited purpose of introducing evidence on the basis of which the Commission could calculate the precise amount collected by Panhandle under bond since February 20, 1952, in excess of the sum found by the Commission to be "just and reasonable." The order indicated that this sum, when

determined, will have to be refunded by Panhandle with 6 per cent interest.

Panhandle owns and operates a natural gas pipeline through which it transports gas from Texas, Oklahoma, and Kansas to Michigan and intervening states. It purchases gas in the field and from other sources, including its own subsidiary, the Trunkline Gas Supply Company, and it also produces gas in the Panhandle-Hugoton gas fields in Texas, Oklahoma and Kansas. For the year 1952, the test year used by the Commission, 22.6 per cent of its total gas supply came from its own production; 25.3 per cent was purchased from Trunkline, its subsidiary; and the balance, 52.1 per cent, was purchased from others. The jurisdictional sales, that is, sales in interstate commerce for resale, amounted to 275,052,339 Mcf out of a total sales volume of 327,530,405 Mcf. Panhandle's own production, or 22.6 per cent of its total supply, amounted during the test year to 73,204,677 Mcf.

Both petitioners assert that the Commission erred (1) in allowing Panhandle the so-called "field price" or "commodity value" for its own produced gas; (2) in not considering profits from Panhandle's gasoline extraction operations when computing the revenues to be recovered by the rates; (3) in denying petitioners' motions to reopen the hearing in order to consider newly discovered evidence. In addition, petitioner City of Detroit urges (4) that the Commission erred in its treatment of accelerated amortization.[2]

[2] Commissioner Draper dissented from the Commission's use of the "field price" formula, the exclusion of the profits of the gasoline extraction plants, and the denial of the mo-

We first consider whether the rates approved are "just and reasonable"[3] notwithstanding the Commission used the "field price" method with respect to Panhandle's own produced gas. In *Federal Power Commission* v. *Hope Natural Gas Co.*, 320 U. S. 591, the Supreme Court approved use of the "prudent investment" rate-base method for establishing rates to be charged by natural gas companies. Since then, until the instant case, the Commission has consistently employed this rate-base method, under which rates are considered "just and reasonable" if they will return to the company a certain percentage of profit on its rate base. The rate base is a figure representing the money prudently invested in the properties and equipment utilized in the company's transmission and production business. The percentage of profit prescribed by the Commission depends upon a variety of factors, such as the risks of the business, the necessity for attracting capital, and the desirability of lower cost of gas to the public. In order to return a profit on the rate base the rates are set high enough to recover all costs of service, including taxes, depreciation, depletion, and all operating expenses chargeable to production and transmission.

tions to reopen; and Commissioner Doty dissented from the Commission's treatment of the amortization question.

[3] "All rates and charges made, demanded, or received by any natural-gas company for or in connection with the transportation or sale of natural gas subject to the jurisdiction of the Commission, and all rules and regulations affecting or pertaining to such rates or charges, shall be just and reasonable, and any such rate or charge that is not just and reasonable is declared to be unlawful." Natural Gas Act § 4 (a), 52 Stat. 822 (1938), 15 U. S. C. § 717c (a) (1952).

In the instant case the Commission substantially modified this traditional rate-base approach by using a different formula for Panhandle's own producing properties. It computed a "field price" for the gas obtained from this source, based upon the "weighted average arm's length prices" established by federally unregulated bargaining for similar gas in the fields.[4] It then multiplied the volume of Panhandle's production by that "field price" and included the result in Panhandle's operating expenses as an amount to be recovered through the rates.[5] At the same time the Commission excluded from the rate base the cost of the properties which produce this gas and excluded from recoverable operating expenses the cost of producing it. The Commission states that its purpose is to allow Panhandle to receive for its own produced gas "a price reflecting the weighted average arm's-length payments for identical natural gas in the fields (and sometimes from the very same wells) where it is produced," instead of a return on its legitimate investment in the properties and equipment used in producing this gas. The Commission points out that the price or value allowed is below the rates of royalties which Panhandle was currently paying on its own production to its lessors, below the prices at which more recent gas purchase contracts have been negotiated in the Hugoton field in Texas and Kansas, and also below the reported recent range of prices in the Pan-

[4] The prices found were 7 cents per Mcf in the Panhandle field in Texas, 9.4978 cents in the Hugoton field in Kansas, and 11 cents in the Hugoton field in Oklahoma.

[5] The total amount allowed for this gas was $5,476,804.

handle field of Texas and in the Gulf Coast area. It terms the amount allowed "a conservative measure of the commodity value of the gas which Panhandle produces." The Commission specifies certain adjustments which bring to $3,571,448 the total difference, applicable to jurisdictional sales, between the amount allowed by the method it adopted and that which would have been allowed by entire use of the traditional rate-base method. This amounts to an over-all increase of 1.3 cents per Mcf.

The Commission fixed a rate base of $148,609,012 for Panhandle's other properties. The accuracy of this amount is uncontested. And the 5.75 per cent rate of return fixed by the Commission on this rate base is also uncontested.[6] Furthermore,

[6] Were the rate-base method applied to Panhandle's own producing properties in the case at hand, the Commission, vigorously disputed by petitioners, says that according to Panhandle's contention, "and its evidence is not contradicted by any facts on this record," the investors would be allowed "less than nothing at the wellhead for each Mcf of the natural gas which it [Panhandle] produces in the Southwest. At the wellhead the staff shows total Cost of Service of $3,399,165, Operating Expenses of $1,957,817, Depreciation, Depletion and Amortization totaling $548,263, and Taxes of $269,799, or total Operating Revenue Deductions of $2,775,879, and a return of $623,286, or .85 cents per Mcf. With the elimination of the tax benefit on account of the depletion allowance, amounting to $537,524, deleted by the staff, however, the net return is reduced to $85,762, or .12 cents per Mfc. And, with the further deduction of $993,306 for Extraction or Production Credits proposed by the staff, this figure is converted into a deficit of $907,544, or *minus* 1.24 cents per Mcf. Thus, on this basis it might be said that, rather than earning a fair return on its production properties, Panhandle would incur a penalty for owning and

we accept as supported by substantial evidence the findings of the Commission regarding the weighted average arm's length prices paid at the wellhead. In the end, therefore, the question is whether the larger amount required to be paid by consumers, $3,571,448 as found by the Commission,[7] than would be charged were the rate-base method followed throughout, removes the prescribed rates from a "just and reasonable" category. If so, they are unlawful under section 4 (a).

Petitioners would have us answer this question affirmatively on the ground that only a traditional rate-base method can lead to "just and reasonable" rates, or, in any event, on the ground that the field price method cannot do so. We think this position is not supported by either the statute or the decisions of the Supreme Court. It is true that in *Federal Power Commission* v. *Hope Natural Gas Co., supra,* the Court spoke in a context which might be thought to presuppose the use of some rate-base method, with latitude only within the limitations of such a method. Thus, petitioners cite the portion of the *Hope* opinion where the Court, in denying

operating them. This penalty would tend to increase with the passage of time as its reserves for depreciation and depletion are built up or if its net revenues from the extraction of hydrocarbons should rise."

[7] This statement of the different results of the two methods, however, should be qualified insofar as it is said to reflect the findings of the Commission itself; for the Commission also said that if the comparison were strictly limited to the results of these methods without the further adjustment made in this case for accelerated amortization, the difference would be decreased by more than half, from a rate differential of 1.3 cents per Mcf to one of 0.6 cents per Mcf.

the Commission power to set rates so as to discourage industrial use of gas and encourage its domestic use, said that section 4 (a) and section 5 (a) "contain only the conventional standards of rate-making for natural gas companies." 320 U. S. at 616. But we think this statement, considered in light of the decision made and the specific problem to which the Court was addressing itself, does not mean that use of the field price is necessarily prohibited and that the rate-base method is mandatory for all properties in all circumstances. The holding in the case is inconsistent with such a meaning, for the Court declined even to consider an alleged error in the method used, saying,

> "* * * it is the result reached not the method employed which is controlling. * * * If the total effect of the rate order cannot be said to be unjust and unreasonable, judicial inquiry under the Act is at an end. * * * And he who would upset the rate order under the act carries the heavy burden of making a convincing showing that it is invalid because it is unjust and unreasonable in its consequences." 320 U. S. at 602.

Petitioners refer to a footnote in the *Hope* opinion where it is said that section 6 in its reference to "actual legitimate cost" and "original cost" "comes the closest to supplying any definite criteria for rate making." 320 U. S. at 601 n. 8. But the implication is that the Court does not feel that section 6 completely restricts the Commission to consideration of factors related to costs. Moreover, other statements in the *Hope* decision are adverse to petitioners' contention. At one point the Court said that Congress,

> "* * * has provided no formula by which the 'just and reasonable' rate is to be determined. It has not filled in the details of the general prescription of § 4 (a) and § 5 (a). It has not expressed in a specific rule the fixed principle of 'just and reasonable.'" 320 U. S. at 600–601.

In the later case of *Colorado Interstate Co.* v. *Federal Power Commission*, 324 U. S. 581, when the general subject was again thoroughly reviewed, the Court, in holding that the Commission was not required to exclude gathering facilities from the rate base and allow "the fair field price of the gas as a commodity" in operating expenses, added, "We do not say that the Comsion lacks the authority to depart from the rate-base method. We only hold that the Commission is not precluded from using it. * * *" 324 U. S. at 601. See, also, *Federal Power Commission* v. *Natural Gas Pipeline Co.*, 315 U. S. 575, 586.

Thus the wording of section 4 (a) in broad terms of "just and reasonable" rates, and the construction given the statute in the *Hope, Coloradio Interstate*, and *Natural Gas* cases, convince us that the allowance of a field price for the utility's own produced gas as an element in the ultimate composition of rates is not unlawful merely because it departs from the traditional rate-base method. But, of course, such an innovation must not lift the rates above the "just and reasonable" standards of the statute.[8]

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[8] These standards, in turn, are within those of the Constitution. *Federal Power Commission v. Natural Gas Pipeline Co.*, 315 U. S. at 586.

Petitioners also contend that the formula used results in rates which are not the lowest reasonable rates, and hence they are unlawful under section 5 (a), which provides that the Commission "may order a decrease where existing rates * * * are not the lowest reasonable rates." True it is that the rates would be lower were the rate-base method used throughout; and it is equally true that such rates may be "just and reasonable." But we think section 5 (a) does not mean that rates which are not the lowest reasonable rates cannot also be "just and reasonable" under section 4 (a). Rather, it means that a decrease ordered by the Commission which leaves the utility with rates which are non-confiscatory will not be held invalid; that is, section 5 (a) permits but does not compel the Commission to go to the very limit of constitutional power. See *Federal Power Commission* v. *Natural Gas Pipeline Co.*, 315 U. S. at 585–586. If Congress had intended "lowest reasonable" to be the uniform criterion it would not have relegated that standard to a proviso in section 5 (a), but instead would have incorporated it in section 4 (a). Moreover, it cannot be said that petitioners' interpretation of section 5 (a) is required by reason, in view of the obvious practical difficulties which would result from forcing the Commission always to set rates at the very brink of confiscation.

Although the Commission cannot be compelled to fix rates at the lowest level of reasonableness, nevertheless it remains true that the primary aim of the Act, in the words of the Supreme Court, is "to protect consumers against exploitation at the hands of natural gas companies." *Federal*

*Power Commission* v. *Hope Natural Gas Co.*, 320 U. S. at 610. See, also, *id.* at 612; *Philips Petroleum Co.* v. *Wisconsin*, 347 U. S. 672, 685. With this in mind we continue our inquiry whether the rates under review conform with the standards of section 4 (a).

The fair field price, which as we have seen results in higher rates than would have resulted from the traditional rate-base method, is not an item of cost. Its inclusion as an amount to be recouped from consumers as though it were a cost incurred by Panhandle must find some other justification within the periphery of the "just and reasonable" standards. It is not an ingredient of any of the usual needs of a regulated utility, that is, to obtain revenues for operating expenses, for preservation of its financial integrity, for capital costs, for servicing of debt and payment of dividends, or for delayed rentals or costs of exploration and development. See *Federal Power Commission* v. *Hope Natural Gas Co.*, 320 U. S. at 605, 615. The Commission, however, advances other factors of an economic character as justification. We may not deny these a place in the total structure underlying rates if, in a balancing of investor and consumer interests, they are brought by evidence and findings into rational relationship to what is "just and reasonable." See *Federal Power Commission* v. *Hope Natural Gas Co.*, 320 U. S. at 603, 615. And in considering whether the two interests are properly balanced we must keep in mind the basic purpose of the statute to protect consumers from excessive rates, though at the same

time the statute affords the support of public authority to the regulated utility.

The Commission expresses the basic problem in these words:

> "* * * The question here presented is what method of pricing pipeline-produced gas will, under present-day realities and in the light of the facts of record in this case, best serve the ultimate public interest. * * *"

In resolving this question in favor of the use it made of the field price the Commission states that the traditional rate-base system (1) tends unduly to accelerate consumption of gas, (2) does not sufficiently encourage its discovery and development, thus failing to promote the national interest in both the production and use of natural gas, and finally, (3) that the interest of the public definitely lies in the direction of natural gas production by pipeline systems themselves as distinguished from their complete dependence for gas upon purchases from other producers.[9]

[9] In addition to these reasons, the Commission discussed the "economic incongruity" resulting from use of the traditional rate-base system, whereby Panhandle would receive a different amount of money for the gas it produces than other producers receive for gas in some instances coming from the same well and going to the same consumers. In his dissent in *Federal Power Commission* v. *Hope Natural Gas Co.*, 320 U. S. at 628, and in his concurring opinion in *Colorado Interstate Gas Co.* v. *Federal Power Commission*, 324 U. S. 581, 608, Mr. Justice Jackson dwelt at some length on the "delirious" and "capricious" results of using the rate-base method for natural gas pricing. The Commission quoted extensively from these opinions to bolster its position.

The Supreme Court pointed out in the *Hope* case the Commission was faced with the problem of determining the amount which a private operator should be allowed to earn from the sale of natural gas across state lines through an established distribution system. "Secs. 4 and 5, not § 7, provide the standards for that determination." 320 U. S. at 612. There West Virginia claimed the Commission should have considered whether the establishment of low rates would not "hasten the abandonment of low-yield high-cost marginal wells." See 320 U. S. at 608–614. In holding that the Commission could not base its order on such "considerations of conservation," the Court pointed out that "the Act does not intrude on the domain traditionally reserved for control by state commissions; and the Federal Power Commission was given no authority over 'the production or gathering of natural gas.' § 1 (b)." 320 U. S. at 612–613. On this record we believe the problem of accelerated usage is like those "considerations of conservation" with which the Commission has not been empowered

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Both Commissioner Draper and petitioners contend that adoption of the field price system in the instant case did not correct the evils discussed by Mr. Justice Jackson. Whether or not this be true, and whatever the theoretical merits of the Commission's arguments, it cannot provide a basis for setting rates under the Act. The only factors which may move the Commission are those related to the public interest. Symmetry of prices per se has no such relation. The Commission tacitly conceded this when it stated: "Apart from the economic incongruity of such a price situation, there is the fundamental and paramount question, whether such result would be in the public interest. * * *"

to deal except in problems arising under sections 7 and 11.[10]

As to the remaining two grounds advanced by the Commission, we think they are within the scope of the Act. The first is the need for encouraging exploration and development of gas resources. The *Hope* opinion indicates that the Commission may consider this factor, at least to the extent of allowing recovery of development and exploration costs. Whether the Commission can go further, as it did in the instant case, we need not decide, at least not on the present record, since, as will appear, we base our decision on this point upon a different reason than lack of power in the Commission. The final ground, the one the Commission appears chiefly to rely upon, is that ownership by pipeline companies of their own producing facilities, instead of their complete dependence for gas supply on purchases from other producers, would serve the public interest by ultimately resulting in lower rates. This would come about, the Commission states, because producing companies would have greater bargaining power when contracting for gas purchases, and would also be able to use their own gas in such a man-

[10] The Court in *Hope* pointed out that § 7 may give the Commission authority to consider certain aspects of conservation when deciding whether facilities or services should be abandoned or extended. 320 U. S. at 612. But the Court concluded that no § 7 issue was involved in *Hope*, and we believe it to be clear that none is present here. Conservation may also become the concern of the Commission under § 11, which directs the Commission to aid states which propose to Congress interstate compacts dealing with the conservation, transportation, production, or distribution of natural gas.

ner that the gas from other companies could be obtained at a relatively uniform rate, thereby enabling the pipeline companies to acquire such gas at a lower price because of certain clauses in the typical gas purchase contracts. The Commission adds a further public interest factor, that consumers remote from production sources would be assured of adequate continuous supply.

While as we have indicated the Commission may be empowered to consider some of these factors it must also, and always, relate its action to the primary aim of the Act to guard the consumer against excessive rates. If the Commission contemplates increasing rates for the purpose of encouraging exploration and development, or the ownership by pipeline companies of their own producing facilities, it must see to it that the increase is in fact needed, and is no more than is needed for the purpose. Further than this we think the Commission cannot go without additional authority from Congress.

The amount allowed Panhandle for the encouragement referred to is not shown to meet this test by any evidence and findings. Of course the rate increase attributable to producing properties might have a tendency to encourage their ownership, and perhaps also the development of new sources of production, as an even greater increase also might do.[11] But the question is whether a

[11] The findings afford no reasonable basis, however, for believing that the increase in rates, amounting to only 1.3 cents per Mcf on Panhandle's total sales, would cause any appreciable reduction in gas consumption.

lesser amount would suffice.[12] The amount here allowed is not brought into relationship by the evidence and findings with the purposes for which it is granted except that it affords a larger revenue to Panhandle than otherwise it would have. This is not an adequate basis for bringing the resulting rates within the "just and reasonable" standards of the Act. The mere fact that the field price method is used does not vindicate the rates. Its use can be justified only in terms of a demonstrated public interest.[13] In this case an allowance for the desired purposes, assuming they are valid, could be included without resort to the field price system. When the latter method is used the evidence and findings must show that the increase in rates thus caused is no more than is reasonably

[12] Commissioner Draper points to several recent cases in which the field price method was not used, *e. g., In the Matter of United Fuel Company*, Opinion No. 258, August 7, 1953, and inquires whether the Commission practice will be to allow the field price only if the pipeline company requests it. It should be noted that the cases cited by Commissioner Draper were decided before the instant case. If the Commission were uniformly to apply the field price system, all risks of exploration and development would be placed upon the pipeline companies. On the other hand, if the Commission gives the companies their option, the traditional rate-base system would naturally be chosen whenever costs of production exceed the field price. In that event, no risks of exploration, development, or production would fall upon the companies, and it would appear that a small margin of profit should suffice to encourage such activities. It is doubtful that the same margin of profit would be required as might be received by producers who bear their own risks. Yet the field price system would seem to have the effect of putting pipeline companies on a par with such producers.

[13] See note 9 *supra*.

necessary for the purposes advanced for any increase. Since there is nothing in these proceedings from which such a conclusion could be drawn, they are fatally defective.[14] In other words, we do not substitute "our opinions for the expert judgment of the administrators to whom Congress entrusted the decision." *Federal Power Commission* v. *Hope Natural Gas Co.*, 320 U. S. at 615. We simply say that if the Commission is now to abandon the treatment historically accorded pipeline-produced gas in rate making on the ground that the ultimate public interest will be better served thereby, the Commission should justify it on the record.

An additional explanation of our view is desirable. We should not be understood to say that whenever the Commission does establish the necessary relationship between means and end, a prescribed rate increase will be lawful. In view of the primary orientation of the Act toward the maintenance of low prices for the consumer, we do not preclude the possibility that a rate increase might be unlawful even though no lower rate could encourage gas production by pipeline companies. On this record, however, if the necessary relationship had been shown we would not consider the rates so high as to be unlawful.

Furthermore, it is seen that when we refer to an "increase" we mean an increase in the

[14] As to the necessity of evidence and findings to enable review consistently with statutory authority, see *Capital Transit Co.* v. *Public Utilities Commission*, 93 U. S. App. D. C. 194, 200–202, 213 F. 2d 176, 182–184, *cert. denied*, 348 U. S. 816, and cases cited.

rates above those which would result from use of the conventional rate-base method. For, though we hold that method not to be the only one available under the statute, it is essential in such a case as this that it be used as a basis of comparison. It has been repeatedly used by the Commission, and repeatedly approved by the courts, as a means of arriving at lawful—"just and reasonable"—rates under the Act. Unless it is continued to be used at least as a point of departure, the whole experience under the Act is discarded and no anchor, as it were, is available by which to hold the terms "just and reasonable" to some recognizable meaning.

It may be thought that our reference to the rate-base method, as well as our holding that the Commission's use of the field price is invalid because not properly related to the public interest by the evidence and findings, is inconsistent with the "end result" test employed by the Supreme Court in the *Hope* case. We think not. That test was applied in assessing the reasonableness of rates from the company's point of view. See 320 U. S. at 603. The factors comprising the test were enumerated by the Court—successful business operation, maintenance of financial integrity, attraction of necessary capital, and compensation of investors for risks assumed. See 320 U. S. at 605. From the consumer standpoint no such criteria are available.

On this branch of the case we will set aside the order of the Commission, but will remand the case to enable the Commission, if it so desires, to seek to supplement the record and find-

ings consistently with the views hereinabove expressed. In such proceedings, the Commission should also consider the impact of *Phillips Petroleum Co.* v. *Wisconsin*, 347 U. S. 672, upon its stated reasons for desiring to encourage pipeline companies to produce their own gas. In *Phillips*, decided subsequently to the Commission's order in the instant case, the Supreme Court held that the Federal Power Commission has jurisdiction "over the rates of all wholesales of natural gas in interstate commerce whether by a pipeline company or not and whether occurring before, during, or after transmission by an interstate pipeline company." 347 U. S. at 682. The effect of the decision will probably be to subject to federal regulation the prices paid by pipeline companies for most of the gas they purchase. Consequently, the question of indirectly influencing these prices by the means here chosen by the Commission, such as augmenting the bargaining power of the pipeline company, may be considerably affected.

There is one other respect in which we are unable to agree with the Commission. It found that Panhandle turns over to Phillips Petroleum Company at the latter's Sneed gasoline extraction plant certain volumes of gas which Panhandle purchases and produces in the Panhandle field. Phillips extracts the gasoline and returns the residue gas to Panhandle for transmission and sale. Panhandle's estimated net revenue from this operation in the test year 1952 was found to be $667,348. Panhandle also owns and operates the Liberal Gasoline Plant in Kansas, at which another portion of its purchased and produced gas is processed and the extracted gas-

oline and other hydrocarbons sold under contract to the Shamrock Oil and Gas Company. The estimated net revenues from this operation in the test year 1952 were $1,315,577. Prior to its present decision, the Commission had in numerous cases credited such revenues to the operating expenses to be recovered in the rates. See, *e. g.*, *In the Matter of Hope Natural Gas Company*, 3 F. P. C. 150, 178; *In the Matter of Cities Service Gas Company*, 3 F. P. C. 459, 480–481; *City of Columbus* v. *United Fuel Gas Company*, 5 F. P. C. 279, 290. The Commission's action in the first two of these cases received appellate court sanction. See *Hope Natural Gas Co.* v. *Federal Power Commission*, 134 F. 2d 287, 307–308, *reversed on other grounds*, 320 U. S. 591; *Cities Service Gas Co.* v. *Federal Power Commission*, 155 F. 2d 694, 703, *cert. denied*, 329 U. S. 773. The only justification for not following a similar practice in this case, in the words of the Commission, is "the rates which we prescribe for the sale of natural gas for resale should not rest in part upon the fluctuating and unregulated prices of natural gasoline and other liquid hydrocarbons." To this statement is appended a footnote reading, "The market prices of gasoline have varied over the years from less than 2¢ to a high of 8¢ per gallon—the estimated price for the test year 1952 being 6.4¢ per gallon for natural gasoline and 3.04¢ per gallon for liquefied petroleum gas."

The Commission feels free to disregard its prior decisions because it concludes that the treatment there given this problem was "bottomed on findings that the processing was 'necessary to

make the natural gas marketable and transportable,'" or "was '* * * an essential part of the business of transporting and marketing the natural gas.'"[15] The Commission says that the evidence before it would not support a similar finding with respect to Panhandle's extraction operations. Therefore the Commission concludes that Panhandle's extraction operations should be "treated as non-jurisdictional." It appears the Commission did not mean to say that there was a jurisdictional bar to crediting the extraction revenues to operating costs, but rather intended to treat the extraction phase of Panhandle's business as non-jurisdictional in order to implement its policy of eliminating fluctuations in rates. The Commission stated:

> "* * * We do not rest our decision * * * upon the question of jurisdiction, for the record clearly shows that certain

[15] There is some doubt as to whether the Commission is correct in its interpretation of these prior cases. Its finding in *In the Matter of Cities Service Gas Company*, 3 F. P. C. 459, 480–481, was phrased in these words: "This operation is profitable and renders the natural gas more readily marketable and transportable. The extraction of gasoline and other residuals reduces the heat content and consumes a certain volume of the natural gas. Accordingly, the gas consumers are entitled to a fair proportion of the net earnings derived from the processing operations." Thus the Commission found, not that extraction was absolutely necessary for transporting and marketing the gas, but that it was quite helpful. It is true that in affirming, the appellate court referred to the extraction process as an "essential part of the business of transporting and marketing the natural gas * * *." *Cities Service Gas Co.* v. *Federal Power Commission*, 155 F. 2d 694, 703, but this was not the language of the Commission.

> of the facilities of Panhandle with respect to which we have unquestioned jurisdiction are jointly used by the gasoline business and in the business of transporting and selling natural gas in interstate commerce for resale. Likewise, expenses are jointly incurred in the purchase, production, gathering, and transportation of the raw natural gas from the wellmouth or points of purchase to the gasoline plants."

The Commission also found that though the extraction process was not necessary to Panhandle's pipeline operations, it was desirable:

> "* * * While we believe the evidence shows it to be a fact that Panhandle would be able to discontinue the extraction of gasoline without incurring serious operating difficulties, nevertheless it is also true that the reduction in the liquid content of the gas through the extraction of the heavier hydrocarbons does improve the operating efficiency of Panhandle's pipeline system."

These facts regarding the usefulness of the extraction process to the transmission operations, the joint use of facilities, and the joint incurring of expenses, coupled with the obvious fact that the extraction process is incident to the overall pipeline transmission and resale operations, clearly bring the extraction operations within the jurisdiction of the Commission.

We believe the fact that crediting extraction revenues to operating expenses may cause some unspecified and apparently slight effect on rates because of fluctuation in the price of gasoline is not a valid basis for refusing to credit the extrac-

tion revenues of Panhandle to operating costs or costs of service. Most of the costs which must be recovered through the rate, such as labor and equipment expenses, are subject to frequent changes, but the Commission has been able to adjust rates satisfactorily. Moreover, it may be noted that were the field price used as the Commission proposes, it would undoubtedly vary from time to time. The similar problem of fluctuation in gasoline prices would not seem to impose a sufficiently heavy additional burden upon the Commission to justify depriving the consumer of a substantial credit, approximately $2,000,000 in this case, upon the costs to be recouped through the rates.

Since the reason given by the Commission for the failure to give credit for these revenues is unacceptable to the court, and the Commission has failed to demonstrate a basis for its conclusion that the extraction business should be treated as non-jurisdictional "to the extent that such extraction is not requisite to preparation of the gas for pipe-line transportation," as it said, credit for these revenues should be given. If there were any danger that these desirable extraction operations would be discontinued unless the profits inured solely to the benefit of the stockholders, a different question might be presented. But the history of the problem in this and other cases does not give basis for such a supposition.

We do not disturb the Commission's solution of the problem created by federal income tax savings resulting from accelerated amortization. Such amortization is permitted under certificates of

necessity, applicable to emergency facilities, issued pursuant to section 124A of the Internal Revenue Code, 26 U. S. C. § 124A (1952),[16] to encourage construction in the interest of national defense. Panhandle has had an aggregate investment of $10,563,609 certified for accelerated amortization. Under section 124A Panhandle is authorized to charge off this total amount to depreciation in five years, regardless of the estimated useful life of the properties, thus accelerating the amortization of these facilities. The Commission points out that the savings in federal income taxes thus effected for each of the five years will be

> "* * * the difference between what taxes it [Panhandle] would otherwise have been required to pay without accelerated amortization and the taxes actually paid."

The Commission continues,

> "* * * We have computed the tax payments which would have been required without the accelerated amortization which Panhandle is permitted, and for the purposes of the rate schedules under study have considered that Panhandle will be allowed as operating expenses such normalized taxes. This does not allow Panhandle for rate purposes more than a fair return over the long period, but does recognize the grant by Congress of certain temporary tax savings under Section 124A."

Since, however, Congress intended by section 124A only to defer tax liability, and not to provide a fund which could be diverted by Panhandle

[16] Now § 168 of the Internal Revenue Code of 1954.

to the payment of dividends, the Commission further states, "the accruals for taxes in excess of those actually paid should logically be treated by Panhandle, not as free and unrestricted income, but earmarked to provide for the future meeting of such liability." After the facilities have been fully depreciated under the accelerated amortization plan, income taxes will normally be greater, since no further deductions for depreciation will be possible. By setting up a special reserve for the tax saving of the first five years, the Commission insures that this amount will go to meet the increased taxes after that period, rather than being paid out in dividends.

Petitioners object to the Commission's method of "normalizing" income tax expense, by which all computations are made as if amortization were not accelerated. They contend that in order to hold rates to a "just and reasonable" level, the savings effected by the accelerated amortization should partly inure to the benefit of consumers. They propose that this be accomplished by treating the saving simply as ordinary depreciation would be treated. That is, in computing recoverable expenses, the income tax expense would be figured at its actual, instead of "normalized," amount, but depreciation expense would be set at the accelerated figure. Thus the same saving would accrue to Panhandle, but under the name of depreciation expense rather than income tax expense. The difference, however, would lie in this, that amounts recovered as depreciation expense are deducted from the rate base. Thus in essence petitioners' plan would allow Panhandle its yearly saving for the five year period, but

would deduct the amount of that saving each year from the rate base.

This plan was rejected by the Commission, which concluded, we think correctly, that the intent of Congress reflected in section 124A is not to benefit consumers but rather the taxpayer in order to encourage construction of certain emergency types of facilities. Were the tax savings deducted from the rate base, the taxpayer here would not receive the intended benefit. The valuations upon which it is entitled to earn a fair rate of return would be decreased by the amount of the savings. In placing the savings at the disposal of Panhandle under the limitations specified, the Congressional intent is effectuated. The funds go into a reserve account for the payment of the deferred taxes to accrue after the five year amortization period. Though thus earmarked, the funds are available for income-producing purposes. Unless this is permitted, it is difficult to see how Panhandle could benefit substantially from section 124A.[17] This statute, unlike the

[17] Petitioner City of Detroit and Commissioner Doty contended that Panhandle would benefit by being able to write off the property in a short period of time. But even if that be considered an advantage, the question is whether it alone would fulfill Congressional intent. Panhandle points out that if it had to deduct the tax saving from the rate base, it would probably lose in the long run. The two primary uses for the saving would be reinvestment, by virtue of which the money would again go into the rate base, and retirement of debt. Panhandle argues forcefully that if it used the tax saving to retire debt, it would save only the interest on its debt, while giving up 5.75% return on that same amount. Thus Panhandle would suffer a net loss, since the interest cost of debt is generally less than 5.75%. On the other hand,

Natural Gas Act itself, is not for consumer benefit. It has a different public policy and should be given effect as intended by Congress. Furthermore, the solution of the Commission does not result in higher rates to the consumer. It simply does not operate to reduce them. It aids Panhandle but neither aids nor harms petitioners. We think this is the result sought by Congress.

Finally, we agree with the Commission that it was not required to reopen the proceedings. Petitioners sought such reopening to permit proof of increased sales volume. Evidence of such increase was offered in the effort to show that the unit cost of service would be reduced. The parties agree, however, that 1952 was a proper test year, and the Commission made its calculations on the basis of evidence available as to that year. We find no abuse of discretion in the Commission's refusal to reopen for evidence subsequently available, especially as there is no clear indication that the evidence offered, considered with all factors involved, would likely lead to a different result. See *Interstate Commerce Commission* v. *Jersey City,* 322 U. S. 503, 514–515.

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if the tax saving were used to reinvest in plant, there would also probably be a net loss because there would inevitably be a lag between the time the money becomes available and the time it is added to the rate base. Thus it seems clear that if rapid writing off of investment be an advantage which would accrue to Panhandle under petitioners' proposal, it might be too easily offset by disadvantages for us to conclude that it was the sole benefit to investors contemplated by Congress. This conviction is reinforced, of course, by the fact that there is no indication of a Congressional intent to benefit consumers.

Because of our view that allowance of the fair field value of Panhandle's own produced gas as an operating expense is not here supported by the evidence and findings to be in the public interest, and because of our disagreement with respect to the Commission's failure to credit the revenues of the gasoline extraction operations, the order under review is

*Set aside and the cases are remanded to the Commission for further proceedings not inconsistent with this opinion.*

# APPENDIX

United States Court of Appeals
for the District of Columbia Circuit

October Term 1955

No. 12351

CITY OF DETROIT, MICHIGAN, A MUNICIPAL CORPORATION, PETITIONER

*v.*

FEDERAL POWER COMMISSION, RESPONDENT
PANHANDLE EASTERN PIPE LINE COMPANY, INTERVENOR

October Term 1955

No. 12359

COUNTY OF WAYNE, MICHIGAN, A MUNICIPAL CORPORATION AND BODY POLITIC, PETITIONER

*v.*

FEDERAL POWER COMMISSION, RESPONDENT
PANHANDLE EASTERN PIPE LINE COMPANY, INTERVENOR

On Petitions for Review of Order
of the Federal Power Commission

Before: FAHY, DANAHER and BASTIAN, Circuit Judges.

JUDGMENT

These cases came on to be heard on the transcript of the record from the Federal Power Commission, and were argued by counsel.

On Consideration Whereof, It is ordered and adjudged by this Court that the order of the said Federal Power Commission on review herein be, and the same is hereby, set aside, and that these cases be, and they are hereby, remanded to the said Federal Power Commission for further proceedings not inconsistent with the opinion of this Court.

Dated: December 15, 1955.

Per Circuit Judge,
/s/ FAHY, C. F.

# APPENDIX

United States Court of Appeals
for the District of Columbia Circuit

January Term, 1956

No. 12351

CITY OF DETROIT, MICHIGAN, A MUNICIPAL CORPORATION, PETITIONER

*v.*

FEDERAL POWER COMMISSION, RESPONDENT
PANHANDLE EASTERN PIPE LINE COMPANY, INTERVENOR

No. 12359

COUNTY OF WAYNE, MICHIGAN, A MUNICIPAL CORPORATION AND BODY POLITIC, PETITIONER

*v.*

FEDERAL POWER COMMISSION, RESPONDENT
PANHANDLE EASTERN PIPE LINE COMPANY, INTERVENOR

Before: FAHY, DANAHER, and BASTIAN, Circuit Judges, in Chambers.

ORDER

Upon consideration of the intervenor's petition for rehearing and of respondent's petition for rehearing and of the answer thereto filed by City of Detroit, it is

ORDERED by the Court that the aforesaid petitions be, and they are hereby, DENIED.

*Per Curiam.*

Dated: February 28, 1956

DANAHER, Circuit Judge, dissenting in part: When these cases were before us I had certain misgivings. Apart from my feeling that, in principle, natural gas should be regarded as a commodity and hence a competing fuel, I am concerned about the nonjurisdictional gasoline sales. I think the Commission might well have convinced us that it had a proper basis for excluding the gasoline extraction credits. The petitions for rehearing have bestirred my doubts to the extent of leading me to believe that we should rehear the parties on this point, and I would have granted rehearing accordingly.

# APPENDIX

## NATURAL GAS ACT—PERTINENT SECTIONS

June 21, 1938, c. 556, 52 Stat. 822; 15 U. S. C. 717 et seq.

February 7, 1942, c. 49, 56 Stat. 83; 15 U. S. C. 717 f(c-g).

July 25, 1947, c. 333, 61 Stat. 459; 15 U. S. C. 717 f(h).

March 27, 1954, c. 115, 68 Stat. 36; 15 U. S. C. 717 (c).

### RATES AND CHARGES; SCHEDULES; SUSPENSION OF NEW RATES

SEC. 4. (a) All rates and charges made, demanded, or received by any natural-gas company for or in connection with the transportation or sale of natural gas subject to the jurisdiction of the Commission, and all rules and regulations affecting or pertaining to such rates or charges, shall be just and reasonable, and any such rate or charge that is not just and reasonable is hereby declared to be unlawful.

(b) No natural-gas company shall, with respect to any transportation or sale of natural gas subject to the jurisdiction of the Commission, (1) make or grant any undue preference or advantage to any person or subject any person to any undue prejudice or disadvantage, or (2) maintain any unreasonable difference in rates, charges, service, facilities, or in any other respect, either as between localities or as between classes of service.

(c) Under such rules and regulations as the Commission may prescribe, every natural-gas com-

pany shall file with the Commission, within such time (not less than sixty days from the date this act takes effect) and in such form as the Commission may designate, and shall keep open in convenient form and place for public inspection, schedules showing all rates and charges for any transportation or sale subject to the jurisdiction of the Commission, and the classifications, practices, and regulations affecting such rates and charges, together with all contracts which in any manner affect or relate to such rates, charges, classifications, and services.

(d) Unless the Commission otherwise orders, no change shall be made by any natural-gas company in any such rate, charge, classification, or service, or in any rule, regulations, or contract relating thereto, except after thirty days' notice to the Commission and to the public. Such notice shall be given by filing with the Commission and keeping open for public inspection new schedules stating plainly the change or changes to be made in the schedule or schedules then in force and the time when the change or changes will go into effect. The Commission, for good cause shown, may allow changes to take effect without requiring the thirty days' notice herein provided for by an order specifying the changes so to be made and the time when they shall take effect and the manner in which they shall be filed and published.

(e) Whenever any such new schedule is filed the Commission shall have authority, either upon complaint of any State, municipality, or State commission, or upon its own initiative without complaint, at once, and if it so orders, without

answer or formal pleading by the natural-gas company, but upon reasonable notice, to enter upon a hearing concerning the lawfulness of such rate, charge, classification, or service; and, pending such hearing and the decision thereon, the Commission, upon filing with such schedules and delivering to the natural-gas company affected thereby a statement in writing of its reasons for such suspension, may suspend the operation of such schedule and defer the use of such rate, charge, classification, or service, but not for a longer period than five months beyond the time when it would otherwise go into effect: *Provided,* That the Commission shall not have authority to suspend the rate, charge, classification, or service for the sale of natural gas for resale for industrial use only; and after full hearings, either completed before or after the rate, charge, classification, or service goes into effect, the Commission may make such orders with reference thereto as would be proper in a proceeding initiated after it had become effective. If the proceeding has not been concluded and an order made at the expiration of the suspension period, on motion of the natural-gas company making the filing, the proposed change of rate, charge, classification, or service shall go into effect. Where increased rates or charges are thus made effective, the Commission may, by order, require the natural-gas company to furnish a bond, to be approved by the Commission, to refund any amounts ordered by the Commission, to keep accurate accounts in detail of all amounts received by reason of such increase, specifying by whom and in whose behalf such

amounts were paid, and, upon completion of the hearing and decision, to order such natural-gas company to refund, with interest, the portion of such increased rates or charges by its decision found not justified. At any hearing involving a rate or charge sought to be increased, the burden of proof to show that the increased rate or charge is just and reasonable shall be upon the natural-gas company, and the Commission shall give to the hearing and decision of such questions preference over other questions pending before it and decide the same as speedily as possible. [52 Stat. 822 (1938); 15 U. S. C. § 717c]

REHEARING; COURT REVIEW OF ORDERS

SEC. 19 (a) Any person, State, municipality, or State commission aggrieved by an order issued by the Commission in a proceeding under this act to which such person, State, municipality, or State commission is a party may apply for a rehearing within thirty days after the issuance of such order. The application for rehearing shall set forth specifically the ground or grounds upon which such application is based. Upon such application the Commission shall have power to grant or deny rehearing or to abrogate or modify its order without further hearing. Unless the Commission acts upon the application for rehearing within thirty days after it is filed, such application may be deemed to have been denied. No proceeding to review any order of the Commission shall be brought by any person unless such person shall have made application to the Commission for a rehearing thereon.

(b) Any party to a proceeding under this act aggrieved by an order issued by the Commission in such proceeding may obtain a review of such order in the circuit court of appeals of the United States[1] for any circuit wherein the natural-gas company to which the order relates is located or has its principal place of business, or in the United States Court of Appeals for the District of Columbia, by filing in such court, within sixty days after the order of the Commission upon the application for rehearing, a written petition praying that the order of the Commission be modified or set aside in whole or in part. A copy of such petition shall forthwith be served upon any member of the Commission and thereupon the Commission shall certify and file with the court a transcript of the record upon which the order complained of was entered. Upon the filing of such transcript such court shall have exclusive jurisdiction to affirm, modify, or set aside such order in whole or in part. No objection to the order of the Commission shall be considered by the court unless such objection shall have been urged before the Commission in the application for rehearing unless there is reasonable ground for failure so to do. The finding of the Commission as to the facts, if supported by substantial evidence, shall be conclusive. If any party shall apply to the court for leave to adduce additional evidence, and shall show to the satisfaction of the court that such additional evidence is material

[1] Circuit Court of Appeals of the United States was redesignated as "United States Court of Appeals" by Act of June 25, 1948, 62 Stat. 870.

and that there were reasonable grounds for failure to adduce such evidence in the proceedings before the Commission, the court may order such additional evidence to be taken before the Commission and to be adduced upon the hearing in such manner and upon such terms and conditions as to the court may seem proper. The Commission may modify its findings as to the facts by reason of the additional evidence so taken, and it shall file with the court such modified or new findings, which if supported by substantial evidence, shall be conclusive, and its recommendation, if any, for the modification or setting aside of the original order. The judgment and decree of the court, affirming, modifying, or setting aside, in whole or in part, any such order of the Commission, shall be final, subject to review by the Supreme Court of the United States upon certiorari or certification as provided in sections 239 and 240 of the Judicial Code, as amended (U. S. C., title 28, secs. 346 and 347).

U. S. GOVERNMENT PRINTING OFFICE: 1934

JUN 1 0 1956

IN THE

# Supreme Court of the United States

OCTOBER TERM, 1955

No. [redacted] 98
No. [redacted] 113

PANHANDLE EASTERN PIPE LINE COMPANY
and
FEDERAL POWER COMMISSION,
Petitioners,
vs.
CITY OF DETROIT, MICHIGAN, and
COUNTY OF WAYNE, MICHIGAN,
Respondents

## BRIEF OF RESPONDENT, COUNTY OF WAYNE, MICHIGAN IN OPPOSITION TO THE PETITIONS FOR WRITS OF CERTIORARI TO THE UNITED STATES COURT OF APPEALS FOR THE DISTRICT OF COLUMBIA CIRCUIT

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## SUBJECT INDEX


| | Page |
|---|---|
| Opinions Below | 2 |
| Jurisdiction | 2 |
| Counter-Statement of Questions Presented | 2-3 |
| Statute Involved | 3 |
| Counter-Statement of the Case | 3-8 |
| Panhandle's Own Gas Production | 5-8 |
| Summary of Argument | 9-12 |
| Argument | 13-47 |
| The Natural Gas Act is designed to protect the ultimate consumer of natural gas | 13-36 |
| The action of the Federal Power Commission in fixing rates for a natural gas company must not be arbitrary nor produce an arbitrary result | 36-41 |
| Approval of the commodity value doctrine will open the door to Panhandle to obtain inordinate profits | 41-44 |
| Both the Commission and the Courts have heretofore unequivocally and without exception treated gasoline and hydrocarbon profits as a factor in production costs under the rate base method | 44-47 |
| Conclusion | 48 |
| Appendix—Material portions from the Natural Gas Act, 15 U. S. C., Sections 717-717w, 52 Stat. 821 | 49-53 |

## INDEX TO AUTHORITIES CITED

Page

City of Columbus, Ohio, v. United Fuel Gas Co. (1946), 5 F. P. C. 279, 290 ..... 45

City of Detroit v. Panhandle Eastern Pipe Line Co. (1942), 3 F. P. C. 273, 289 ..... 45

Colorado Interstate Gas Co. v. Federal Power Commission, 142 F. (2d) 943, affirmed 324 U. S. 581 17

Federal Power Commission v. Hope Natural Gas Company, 320 U. S. 591 ..... 13, 16, 18

Federal Power Commission v. Natural Gas Pipeline Co. of America (1942), 315 U. S. 575 ..... 15, 18, 36

Fla. RR and PUC, re Southern Bell T. & T. Co. (1949), 80 PUR (NS) 161, 170 ..... 27

Ga. PSC, re Georgia Power Co. (1949), 81 PUR (NS) 240, 242 ..... 27

Green Bay v. Wisconsin Public Service Company, PUR 1922B, 671, 679 ..... 45

In the Matter of Cities Service Gas Co. (1943), 3 F. P. C. 459, 580 ..... 45

In the Matter of Hope Natural Gas Co. (1942), 3 F. P. C. 150, 178 ..... 45

In the Matter of United Fuel Gas Co., Dockets No. G-1781, G-2055, Opinion No. 258 ..... 45

Jacksonville Gas Corp. v. Railroad & Public Utilities Commission (1951), 50 So. (2d) 887, 893 29

Kansas State Corporation Commission v. Federal Power Commission ..... 37

La. PSC, ex parte Westside Transit Lines, Inc. (1951), 91 PUR (NS) 56, 57 ..... 28

Mass. Dept. of PU, re New England T. & T. Co. (1949), 83 PUR (NS) 238, 271 ..... 28

Mich. PSC, re Consumers Power Co. (1949), 78 PUR (NS) 315, 326 ..... 27

Page

Mississippi River Fuel Corporation v. Fed. Power Commission (1941), 121 Fed. (2d) 159, 40 PUR (NS) 213 ..... 47
Missouri ex rel. Southwestern Bell Tel. Co. v. U. S. C. (1923), 262 U. S. 276..... 23
Natural Gas Act, 15 U. S. C. Secs. 717-717w, 52 Stat. 831 .....2, 3, 14, 49
N. J. Board of PUC, re N. J. Bell Tel. Co. (1947) 72 PUR (NS) 37, 49..... 26
N. Y. PSC, (1951), re N. Y. Telephone Co., 91 PUR (NS) 231, 256..... 30
Northern Natural Gas. Co., Docket No. G-1382, et al., Opinion No. 228..... 37
Re Great Falls Gas Co., PUR 1922D, 385, 436..... 45
Re Uniform System of Accounts, New York Public Service Commission, First District, PUR 1917D, 122, 138 ..... 45
Re Wisconsin Gas and Electric Co., PUR 1922C, 829, 836 ..... 45
Re Wisconsin Minnesota Light and Power Co., PUR 1922D, 131, 136..... 45
Smyth v. Ames (1898), 169 U. S. 466..... 24
Southwestern Bell Teleph. Co. v. State (1951), 230 P. (2d) 260..... 29
Vt. PSC, re New England T. & T. Co. (1950), 83 PUR (NS) 414, 430..... 28
West v. Chesapeake & P. Teleph. Co., 295 U. S. 662 ..... 29
Wis. PSC, re Wisconsin Electric Power Co. (1952), 93 PUR (NS) 97, 101..... 31
Wyo. PSC, re Mountain States T. & T. Co. (1951), 89 PUR (NS) 341, 439..... 28

IN THE

# Supreme Court of the United States

OCTOBER TERM, 1955

No. 958
No. 976

PANHANDLE EASTERN PIPE LINE COMPANY
and
FEDERAL POWER COMMISSION,
Petitioners,
vs.
CITY OF DETROIT, MICHIGAN, and
COUNTY OF WAYNE, MICHIGAN,
Respondents

## BRIEF OF RESPONDENT, COUNTY OF WAYNE, MICHIGAN IN OPPOSITION TO THE PETITIONS FOR WRITS OF CERTIORARI TO THE UNITED STATES COURT OF APPEALS FOR THE DISTRICT OF COLUMBIA CIRCUIT

The County of Wayne, Michigan, Respondent, prays that this Honorable Court deny the Petitions of the Federal Power Commission and the Panhandle Eastern Pipeline Company, Petitioners, to review the judgment of the United States Court of Appeals for the District entered in the above-entitled cases, on December 15, 1955. Petition for Rehearing was denied February 28, 1956.

## OPINIONS BELOW

The opinion of the Court of Appeals is reported at 230 F. 2d 810. The pertinent opinion and order of the Federal Power Commission are printed in the Joint Appendix, pp. 9276-9943, and are reported at 3 P. U. R. 3d 396.

## JURISDICTION

The judgment of the Court of Appeals was entered on December 15, 1955. Petition for rehearing was denied February 28, 1956. Jurisdiction is conferred upon this Court by 28 U. S. C. §1254 (1) and section 19 (b) of the Natural Gas Act, June 21, 1938, 52 Stat. 831; 15 U. S. C. 717r (b).

## COUNTER-STATEMENT OF QUESTIONS PRESENTED

1. Whether the Federal Power Commission, in a proceeding under the Natural Gas Act to establish the "just and reasonable" rates for the sale in interstate commerce for resale of natural gas by an interstate pipeline company, may lawfully allow to such pipeline company for its own produced natural gas the "weighted average" price of such gas contained in "arm's length" contracts covering sales of gas in the areas of the company's production, or some other measure of the "commodity value" of such gas.

2. Whether the Federal Power Commission's allowance, in a rate determination under the Natural Gas Act, of an average field price or commodity value of natural

gas to an interstate pipeline company for its own produced gas was based upon arbitrary action by the Commission or produced arbitrary results such that the Commission's rate determination is unlawful.

3. Whether, in a proceeding under the Natural Gas Act to determine the just and reasonable rates of an interstate pipeline company, the Federal Power Commission's deliberate refusal to give any consideration to the pipeline company's gasoline extraction operations and facilities, even though the Commission found that such operations and facilities were subject to its jurisdiction, was arbitrary and unlawful and, therefore, resulted in the allowance of unlawful rates.

## STATUTE INVOLVED

The statute involved is the Natural Gas Act (Act of June 21, 1938, ch. 556, 52 Stat. 821, as amended by Act of February 7, 1942, ch. 49, 56 Stat. 83, and Act of July 25, 1947, ch. 333, 61 Stat. 459, 15 U. S. C. sec. 717-717w), the material portions of which are printed in an appendix to this brief.

## COUNTER-STATEMENT OF THE CASE

Panhandle Eastern Pipe Line Company (hereinafter called "Panhandle") produces and purchases natural gas in the Panhandle Hugoton Fields in Texas, Oklahoma and Kansas. It also owns and operates a transmission pipe line system extending from Texas through portions of Oklahoma, Kansas, Missouri, Illinois, Indiana and Ohio to northern termini in Michigan, and is engaged in the transportation and sale of natural gas in interstate commerce to some 49 distributing utilities located along its pipe line system for resale for ultimate public consumption, and also to industries and to others for their own use.

A substantial part of Panhandle's natural gas transported in interstate commerce is sold to Michigan Consolidated Gas Company, located in Detroit, Wayne County, Michigan, and is resold by the latter to ultimate consumers, including residents of Wayne County.

Pursuant to prior opinion and order of the Federal Power Commission (hereinafter called "Commission"), Panhandle, on August 17, 1951 filed with the Commission its Gas Tariff, Original Volume No. 1. Pursuant to the Commission's Opinion No. 214-A, 10 F. P. C. 322, Panhandle, on August 30, 1951, filed with the Commission substitute original sheets to this Tariff and requested that the Tariff as submitted on August 17, 1951 and as modified by the substitute sheets filed on August 30, 1951, be permitted to become effective on September 20, 1951. The Tariff filed by Panhandle proposed an annual increase in rates of approximately $21,400,000.

By Order issued September 5, 1951, the Commission suspended the Tariff until February 20, 1952. Upon motion of Panhandle, the Tariff was allowed, by the Commission's Order issued March 5, 1952, to become effective, under bond, on February 20, 1952. Hearings with respect to the suspended Tariff and other related matters were concluded on May 15 1953.

On April 15, 1954, the Commission issued its Opinion No. 269 and accompanying Order, allowing to Panhandle an annual increase in its rates in the amount of $12,778,864.

**Panhandle's Own Gas Production**

Of the total supply of natural gas available to Panrandle for interstate transmission and sale during the test year (during 1952), 73,204,677 Mcf or 22.6% of its total supply, came from its own production (R. 9742).

In determining the amount which Panhandle would be allowed to include in its rates for its own produced gas, the Commission rejected the "rate base" approach which it had followed without exception since the passage of the Natural Gas Act of 1938 (R. 9743, 9749; 9859).

Under the rate base method heretofore traditionally followed by the Commission, natural gas in place and producing facilities are included in the pipe line company's rate base at their net investment (original cost less accrued reserves for depletion and depreciation) and a reasonable return thereon is included in the company's cost of service. Under this method, the pipe line company is also permitted to recover in its cost of service all operating expenses chargeable to production, including exploratory and developmental expenditures such as delay rentals, geological surveys and expense of drilling dry holes. In addition, all expenses associated with the extraction of liquid hydrocarbons, such as gasoline, are included in the recoverable cost of service and credits are made against the cost of service of the revenues obtained by the Company from the sale of liquid hydrocarbons (R. 9743, 9744).

The conventional original cost rate base approach was applied to the remainder of Panhandle's operations and facilities subject to the Commission's rate-making jurisdiction.

In lieu of applying the original cost rate base approach to Panhandle's own produced gas, the Commission allowed to Panhandle in its recoverable cost of service an amount which the Commission determined to be the "commodity value" of such gas (R. 9745, 9748).

The Commission purported to find the commodity value of Panhandle's own gas production by computing the "weighted average arm's length prices of gas at the well-head in the fields where this gas is produced" (R. 9746).

The Commission found that these prices, at a pressure base of 16.4 pounds, were 7¢ in Texas, 8.4848¢ in Kansas and 11¢ in Oklahoma (R. 9746). The Commission then increased the Kansas price to 9.4978¢ to give effect to well-head price orders of the Kansas Corporation Commission (R. 9747).

The Commission thus arrived at a "weighted average arm's length" price of 8.4398¢ per Mcf for Panhandle's own produced gas. This resulted in an allowance of $5,977,712 for the natural gas produced by Panhandle (R. 9747).

As a consequence of the Commission's substituting the commodity value method for the rate base approach, the rate payers were required to pay after adjustments an additional annual allowance of $3,571,488 to Panhandle for its own gas production (R. 9748).

The weighted average field price used by the Commission for Panhandle's production in Kansas was based solely upon the application of purported contract prices of 5 pipe line companies, including Panhandle, to the allowable production quotas assigned to wells by the Kansas Corporation Commission for the single month of August, 1952. The Oklahoma weighted field price was computed from unit

prices ascribed to 3 pipe line companies, including Panhandle, as applied to the allowable production quotas assigned by the Oklahoma Commission for the same month (R. 8758, 9871). Also the Kansas and Oklahoma purported contract prices appear in most instances to represent minimum wellhead prices prescribed by the Kansas and Oklahoma Commissions rather than arm's length bargained-for prices (R. 9871, 9872; 4709, 4710). There was no demonstration on the record that the prices contained in these contracts covered sales of gas of comparable volumes and quality under similar terms and conditions (R. 9872).

The arm's length prices found by the Commission for Texas were predicated upon a finding by the Railroad Commission of Texas, dated December 8, 1952 that the current market price paid at the wellhead in the Panhandle Field for the first 6 months of 1952 was 6.9377¢. On the basis of similar data, the Texas Railroad Commission determined the price to have been 7.49¢ for the last 6 months of 1952. The Texas Commission's computations appear to be based upon an exhibit prepared by an employee of Natural Gas Pipe Line Company of America in which only 11½% of the volumes of gas considered were valued at prices paid pursuant to gas purchase contracts, with the balance having been valued on the basis of royal payments (R. 9872, 9873; 8777, 8780, 8928, 8929; 5813, 5816). The Commission valued Panhandle's gas produced in Texas at 7¢ per Mcf even though Panhandle paid only an average of 4.3528¢ for gas which it purchased from others in the same field (R. 8780; 9863).

The Commission found that the commodity value of Panhandle's own produced gas is 8.4398 per Mcf although Panhandle paid only an average of 7.745¢ in the field for gas which it purchased from other producers during the test year 1952 under its own contracts (R. 9747).

The Commission found that the royalty rates paid by Panhandle to its lessors were 8¢ in Texas, 9¢ in Kansas and 11¢ in Oklahoma. The Commission also found that recent gas purchase contracts contained prices of from 9.4 to 15¢ in Texas, 12 to 13¢ in Kansas and 20¢ per Mcf in the Gulf Coast area at a pressure of 14.65 pounds (R. 9747).

The Commission treated Panhandle's gasoline extraction operations as non-jurisdictional, even though it stated that it had "unquestioned jurisdiction" over Panhandle's gasoline extraction facilities (R. 9774, 9775).

Treating Panhandle's gasoline extraction facilities and operations as non-jurisdictional constituted another reversal by the Commission of long established policy (R. 9880).

The effect of the Commission's action in this regard was to remove $679,876 from Panhandle's rate base upon which Panhandle would have been allowed a fair return in addition to recovery of its gasoline extraction expenses, and thereby to allow to Panhandle additional profits of $1,082,570 at the expense of the consumers (R. 9880).

The method adopted by the Commission provides to Panhandle a rate of return of 56.71% on its gasoline extraction operations (R. 9881).

The United States Circuit Court of Appeals for the District of Columbia Circuit set aside the Commission's Opinion 269 and accompanying Order and remanded the cases to the Commission for further proceedings. A stay of judgment was granted by the Court to May 22, 1956.

## SUMMARY OF ARGUMENT

By abandoning the "costs plus a fair return on net original investment" doctrine for the "field price" or "commodity value" method of determining the rate allowance to an interstate pipeline company for its own natural gas production, the Commission has violated the basic intent of Congress to protect ultimate consumers against exorbitant charges by pipeline companies.

As demonstrated by the past practice of this Commission and by numerous court decisions, the Commission should carry out the function delegated to it under the Act by prescribing the "lowest reasonable rate" for a natural gas company subject to its jurisdiction.

Rates based upon costs plus a fair return on actual investment are not only the *lowest* reasonable rate, but actually are the *only* reasonable rate. Panhandle's and the Commission's contentions that the cost method is flagrantly discriminatory and inimical to the best interests of ultimate consumers are at best specious and not supported by any evidence adduced by them during the proceedings. Courts and other authorities in the field of utility regulation are in universal agreement that the cost method is the only equitable basis for both investors and rate payers. They recognize that the cost method results in a return which is neither confiscatory of the investors' property nor exorbitant in charge to the consumers.

The acceptance of the cost method for nearly a quarter of a century by practically every regulatory agency in the United States, including the Commission itself until the instant case, should be proof positive of its ultimate rea-

sonableness. The present attempt by Panhandle to upset the cost method in favor of the "field price" is the cumulative outgrowth of all its prior aborted efforts to exploit rate payers for the sole benefit of its stockholders.

Conventional rate making principles require the Commission to establish rates which will exact from the consumers no more than the reasonable cost to the regulated company of providing such service, including a *fair* return to the investors *based upon their investment.*

The primary purpose of the Natural Gas Act is to protect consumers from exploitation at the hands of interstate pipeline companies—*particularly those pipeline companies which own gas supplies.*

An allowance to such a pipeline company of the open market price or commodity value of its own produced gas is in direct contravention of the Congressional intent underlying the Act.

Rate regulation under the conventional *rate base* doctrine is sufficiently flexible to protect the investors' property and to attract additional capital. The Commission may make such adjustments in rate of return and allowances for exploration and development costs as are necessary for this purpose.

Both the method employed by the Commission in determining Panhandle's allowance for its own produced gas and the *results* obtained thereunder are *arbitrary* and consequently render the rates approved by the Commission unlawful *per se.*

Although the Commission purported to use a weighted average of arm's length prices contained in contracts of independent producers, it actually considered other factors, such as minimum well-head price orders of producing

states, which *increased* the commodity value of Panhandle's own produced gas.

The Commission also pointed to other factors, such as royalty payments and prices contained in more recent contracts, which it could have considered in ascertaining an even higher commodity value.

The Commission, therefore, on the face of its own opinion in the instant case, demonstrated that any number of commodity values exist at one time for a pipeline company's own produced gas and that it considered itself free to apply any one of such values to Panhandle's gas. The Commission also demonstrated that its methods for determining commodity value were not consistent as among the three producing states in question and that a variety of incongruous factors exist in any one producing area which can form the basis for the Commission's finding of commodity value.

An allowance of commodity value to Panhandle was granted solely because Panhandle had *requested* such allowance. Although vigorously decrying the application of the conventional rate base method to a pipeline's own produced gas in Opinion No. 269, the Commission has not seen fit to award, on its own initiative, the commodity value of such gas to other pipeline companies in contemporaneous rate cases.

Furthermore, the commodity value was allowed notwithstanding the fact that the *consumers* have since 1938 been underwriting *Panhandle's producing operations* through capital contributions in the form of exploration and development costs plus depreciation and depletion allowances which Panhandle has been permitted to include in its rates.

The signal *result* of the Commission's action in the instant case is the bestowal of a *windfall* upon the *stockhold-*

*ers* of Panhandle to the *detriment* of its *bondholders,* who have supplied the bulk of its capital, and the *consumers* who must foot the bill.

In addition, the Commission has given Panhandle and the other interstate pipeline companies the green light to come back for more, subject to the sole limitation of the imaginations of their respective rate experts.

The failure of the Commission to consider revenues derived by Panhandle from its gasoline extraction process and its failure to include the extraction facilities in the rate base are both novel and fallacious particularly in view of the Commission's own statement that it had "jurisdiction" over this segment of Panhandle's operations. Ever since utilities have been subject to regulation, *all* property held by an utility has been carefully valued for the purpose of determining the proper investment base on which to allow a fair return. Eliminating any part of such property and the revenues derived therefrom from consideration in the rate to be prescribed, results in giving stockholders an unwarranted return on their investment at the expense of the consumers. This proposition was wholly acceptable and scrupulously followed by the Commission itself until the instant case, when without apparent administrative rhyme or judicial reason it suddenly decided to discard it.

## ARGUMENT

### The Natural Gas Act Is Designed to Protect the Ultimate Consumer of Natural Gas

Respondent agrees with Panhandle that this case is the most important rate decision since the *Federal Power Commission v. Hope Natural Gas Company*, 320 U. S. 591, but for an entirely different reason. Respondent submits that by abandoning the "costs plus a fair return on net original investment" doctrine for the "field price" or "commodity value" method of determining the rate allowance to an interstate pipeline company for its own natural gas production, the Commission has violated the basic intent of Congress to protect ultimate consumers against exorbitant charges by pipeline companies.

It is conceded by both Panhandle and the Commission in their Petitions that the traditional original cost rate base method was consistently followed in valuing pipe line produced gas since the enactment of the Natural Gas Act notwithstanding repeated attempts by pipe line companies including Panhandle, to urge the adoption of the commodity value doctrine.

Now, in the instant case, however, the Commission has discarded its long established judicially approved *cost* method of rate regulation and found that the *value* method of natural gas company produced gas is just and reasonable. Panhandle has secured from the Commission a reversal of its basic regulatory philosophy; a philosophy to which the Commission had heretofore steadfastly adhered in numerous cases; and a philosophy which has been sanctioned by the Courts, including this Honorable Court.

The instant case is of great importance to all concerned with the regulation of the natural gas industry engaged in interstate commerce. Respondent concedes for the record that it is of great importance to the owners of the common stocks of natural gas companies holding leases on reserves of natural gas; for if this Honorable Court does not affirm the judgment of the lower court, literally billions of dollars will accrue to such stockholders as additional profits over the life of the gas reserves.

Respondent submits in all earnestness however that, as important as this case may be to Panhandle's stockholders, it is of even greater importance to the untold millions of consumers of natural gas in the United States, the so-called "little people", including residents of the County of Wayne of the State of Michigan represented by the Respondent, who will be compelled to pay increasingly higher rates should this Court reverse the judgment of the lower court. The Respondent believes that this Honorable Court has ample legal and equitable justification to protect the interests of the public.

The Natural Gas Act of 1938 (52 Statutes 821-833; Title 15 U. S. C., §§717-717w) contains the following provision, among others, relating to the authority of the Commission with regard to rates and charges of natural gas companies subject to its jurisdiction:

> "Sec. 5. (a) Whenever the Commission, after a hearing had upon its own motion or upon complaint of any State, municipality, State commission, or gas distributing company, shall find that any rate, charge or classification demanded, observed, charged, or collected by any natural-gas company in connection with any transportation or sale of natural gas, subject to the jurisdiction of the Commission, or that any rule, regulation, practice, or contract affecting such rate, charge, or classification is

> unjust, unreasonable, unduly discriminatory, or preferential, ***the Commission shall determine the just and reasonable rate, charge,*** classification, rule, regulation, practice, or contract *to be thereafter observed*, and in force, and shall fix the same by order: Provided, however, that the Commission shall have *no power to order any increase* in any rate contained in the currently effective schedule of such natural-gas company on file with the Commission, *unless such increase is in accordance with a new schedule filed* by such natural-gas company; *but the Commission may order a decrease where existing rates are unjust, unduly discriminatory, preferential, otherwise unlawful, or are not the lowest reasonable rates.*" (Emphasis supplied.)

It would be hardly more than legal folly (especially in the light of *Federal Power Commission v. Natural Gas Pipeline Co. of America* (1942), 315 U. S. 575), to question the right of the Commission to order a decrease in rate under this section in a situation where the Commission found it to be "unjust" or "unduly discriminatory" or "preferential" or "otherwise unlawful", regardless of whether the natural-gas company involved had filed a schedule for the new decreased rate. (This was actually done by the Commission in an earlier administrative phase of this case, by its Order accompanying Opinion No. 214.) If the Commission *in such a situation* failed to order a decrease in rate, there is no doubt that a Court would find that the Commission had been derelict in carrying out the function delegated to it by Congress under this section.

Is it not also manifestly the intent of Congress that the interest of rate-payers be protected by the "lowest reasonable rate"; otherwise, why regulate the utility at all? And where the Commission has failed to prescribe a rate that is "the lowest reasonable rate", has it not violated its duty

under this section just as much as if it had failed to order a decrease in an "unjust" or "unduly discriminatory" or "otherwise unlawful" rate situation?

Respondent believes that the weight of authority—Courts and text writers alike—must seriously consider its contention, and ultimately resolve it in favor of rate-payers, whose rights under the Act have been arbitrarily and capriciously dealt with by the very body expressly empowered to preserve and defend them. The following excerpt from Justice Jackson's dissenting opinion in *Federal Power Commission v. Hope Natural Gas Co.* (1944), 320 U. S. 591, lends further support to the Commission's duty to fix the "lowest reasonable rate" under Section 5(a):

> "The Natural Gas Act declared the natural gas business to be 'affected with a *public interest*,' and its regulation 'necessary in the *public interest*.' Originally, and at the time this proceeding was commenced and tried, it also declared 'the intention of Congress that natural gas shall be sold in interstate commerce for resale for ultimate public consumption for domestic, commercial, industrial, or any other use at the *lowest possible reasonable rate consistent with the maintenance of adequate service in the public interest*.' While this was later dropped, *there is nothing to indicate that it was not and is not still an accurate statement of purpose of the Act*" (at p. 638, emphasis supplied.)

In *Hope Natural Gas Co., supra,* the majority of the Court relied on its earlier decision in the *Natural Gas Pipeline* case in upholding the Commission's rate-making authority under Section 5(a).

Speaking for the majority, Justice Douglas said:

> "Section 5(a) gives the Commission the power, after hearing, to determine the 'just and reasonable rate' to be thereafter observed and to fix the rate by order. *Section 5(a) also empowers the Commission to order a 'decrease where existing rates are unjust * * * unlawful, or are not the lowest reasonable rates'*" * * *
>
> "When we sustained the constitutionality of the Natural Gas Act in the Natural Gas Pipeline Case, we stated that the 'authority of Congress to regulate the prices of commodities in interstate commerce is at least as great under the Fifth Amendment as is that of the States under the Fourteenth to regulate the prices of commodities in interstate commerce' * * * Rate-making is indeed but one species of price fixing * * * *The fixing of prices, like other applications of the police power, may reduce the value of the property which is being regulated. But the fact that the value is reduced does not mean that the regulation is invalid.*" (Emphasis supplied.)

The *Natural Gas Pipeline* case was followed by the Tenth Circuit Court of Appeals in 1944 when it upheld the Commission's rate making authority in *Colorado Interstate Gas Co. v. Federal Power Commission*, 142 F. (2d) 943, affirmed 324 U. S. 581. In so doing the Court said:

> "The power to regulate commerce is subject to the limitations and guarantees of the Constitution * * * But permissible regulation of rates does not insure that the business shall produce net revenues, *and any rate may be decreased which is not the lowest reasonable rate*" (at p. 954, emphasis supplied).

On appeal the Supreme Court reiterated its earlier holdings in the *Natural Gas Pipeline* and *Hope* cases that the

original cost rate-base doctrine does not result in confiscatory rates. Justice Douglas, for the majority, said:

> "Rate-making is essentially a legislative function. *Munn v. Illinois*, 94 U. S. 113, 24 L. Ed. 77. Congress to be sure has provided for judicial review of the Commission's orders, §19, 15 U. S. C. A. §717r, 4 F. C. A. title 15, §717r. *But that review is limited to keeping the Commission within the bounds which Congress has created.* When Congress, as here, fails to provide a formula for the Commission to follow, courts are not warranted in rejecting the one which the Commission employs *unless it plainly contravenes the statutory scheme of regulation.*" (Emphasis supplied.)

Perhaps no one has better expressed the fundamental philosophy and congressional intent that motivated the enactment of the Natural Gas Act for utility regulation than Commissioner Draper in his dissenting opinion in Opinion No. 269:

> "It has always been, and still is, my firm conviction that as an appointed member of this regulatory Commission I am bound to administer the organic legislative enactment which expresses the will of the Congress with regard to the subject matter intended to be regulated. With that precept in mind, and with my understanding of the Congressional will as expressed and as interpreted by legislative history and court decisions for a number of years, I find that I cannot agree with the majority of my colleagues that there is in the Natural Gas Act such latitude as will permit the establishment of what the majority admits is a new departure in the field of rate-making * * *" (R. 9856).
>
> "In December, 1945, Senator Burton K. Wheeler, at the time Chairman of the Senate Committee on Interstate and Foreign Commerce, and, in my humble opinion, an eminent authority on regulatory

commission matters, made the following succinct statement in an article written for the Federal Power Commission's Silver Anniversary Issue of the George Washington Law Review:

> "'The Commission's duties are prescribed by Act of Congress. It is "charged with the enforcement of no policy except the policy of the law." Its decisions are to be made according to the mandates of the statute and in the "exercise of the trained judgment of a body of experts," informed by their experiences and the record made before the Commission. The Commission is given discretion within the ambit of its authority, *but must observe with strict fidelity the mandates of Congress set forth in its jurisdictional statutes, as interpreted by the courts.*'" (Emphasis supplied.)

"The italicized language speaks for itself" (R. 9856, 9857).

* * *

"The Natural Gas Act provides in Section 4(a) that 'All rates and charges * * * shall be just and reasonable,' and any such rate or charge that is not 'just and reasonable is hereby declared to be unlawful.' In Section 5(a) it is provided that after hearing 'the Commission shall determine the just and reasonable rate * * * and shall fix the same by order' and 'the Commission may order a decrease where existing rates are unjust * * * unlawful, *or are not the lowest reasonable rate.*' (Emphasis supplied.)

"In January of 1944, the five members of this Commission as it was then constituted, including myself, made the following observation in the conclusion to a report entitled, 'The First Five Years Under the Natural Gas Act':

> "'At the time of its enactment, some doubts were expressed as to whether the fundamental

principles, which had been found to be applicable to the regulation of utilities having a substantial permanent physical plant, could be properly applied to an industry whose property consisted in large part of natural-gas reserves which were being continuously drawn upon in its operation.

"'Experience has shown, it is believed, that such principles of regulation are not only applicable to the natural-gas industry but that they are *peculiarly necessary in relation to such an industry for the protection of consumers and investors, as well as for the promotion of the public interest.*'" (R. 9857, 9858, emphasis supplied.)

* * *

"'*The determination of natural-gas rates on the basis of actual legitimate investment, in accordance with the intent of the Congress, has been thoroughly justified and the fundamental principles involved in such determination have been approved by the United States Supreme Court.* From a practical standpoint a striking demonstration of the soundness of this method of rate determination is to be found in the large number of cases in which natural-gas companies have accepted or voluntarily made rate reduction conforming to this standard, without contest and without litigation. It is obvious that corporations would not agree to such reductions, aggregating millions of dollars annually, if they were not convinced that both the methods and results are sound and reasonable.' (Emphasis supplied.)

"As far as I am concerned, that statement is just as valid today as it was then." * * * (R. 9858, 9859.)

"*The majority, as I have already indicated, also provide no standard to be followed in determining the weighted average field price. In this case they have avoided the problem simply by allowing what Panhandle has claimed.* But what of future cases? Is the Commission going to allow whatever the nat-

ural-gas company claims, or is it going to test the contentions, and if so, how? Is the test going to be, as the majority opinion seem to imply, how much the individual consumer can stand in the way of an increase? I would think that in abandoning the rate-base method which has been followed since the inception of rate cases under the Natural Gas Act, the Commission would have to recognize its obligation to provide answers to these question now *and to explain how this new method, which can only mean increased costs of gas to consumers, squares with the command of Section (5), that the rates fixed by the Commission shall be the 'lowest reasonable rates.' If a lower rate for the consumer results from the rate-base method which has so often been upheld by the courts, how can the majority be complying with the Congressional mandate that the 'lowest reasonable rates' be prescribed when they give Panhandle the right to charge a higher rate?*

"The majority attempts to minimize the impact of the increase in rates due to the difference in treatment of producing properties for rate-making by pointing out that the dollar impact of the majority's method upon individual residential customers of the City of Detroit is only the small sum of 24.33¢ per month (a higher Mcf rate of only 1.3¢) more than it would be based on the 'cost' of its own produced gas. It must come as a distinct surprise to students of public utility regulation to find the Federal Power Commission employing such a method in justifying a rate increase. The majority should be aware that the test of a proposed increase or decrease in rates is not the impact on the individual customer. *The test is, of course, whether the proposed rates are reasonable when measured against the company's cost of service, including a fair return which the company should have the opportunity to recover in its rates.*

"If this insignificant impact were a valid criterion, why do the majority here reject Panhandle's claimed allowance for depreciation of $7,571,147 and find $6,824,203 to be the proper amount and in the process devote eleven pages of their opinion to this topic when the difference between the two amounts expressed in return on the rate base and related to all the Mcf of gas sold by Panhandle amounts to only the infinitesimal sum of 0.015344¢ per Mcf, or 0.3836¢ per month to the typical domestic consumer in Detroit? *Has regulation by the Federal Power Commission reached the stage where the test of reasonableness of natural gas rates is the impact on individual consumer bills or 'what the traffic will bear?'* Any such concept is so contrary to fundamental principles of regulation to which I have adhered for the past 35 years that I am astonished my associates would use such arguments." (R. 9878, 9879; emphasis supplied).

* * * *

"The record before us does not, in my opinion, reveal the slightest justification for allowing Panhandle a rate of return higher than is necessary to meet the tests of reasonableness laid down by the United States Supreme Court in *Bluefield Water Works and Improvement Company v. P. S. C.*, 262 U. S. 679, *F. P. C. v. Hope Natural Gas Company*, 320 U. S. 591, and other decisions. And the majority at page 46 of their opinion state:

> '* * * we are duty bound to allow Panhandle and the other regulated companies a fair return, *and no more*, and this we propose to do in the present instance.' (Emphasis supplied.)

"But while the majority find and determine 5¾% to be the fair rate of return they actually permit Panhandle to collect rates which produce a much higher rate of return. So that it may be possible to ascertain the true effect of the majority decision, I have had two tables prepared (Appendices A and

> B hereto which reveal the actual income of Panhandle and the rate of return earned under the majority decision which divides Panhandle's utility business into departments and designates portions thereof as non-utility business." (R. 9882, 9883).

Rates based upon costs plus a fair return on actual investment are not only the lowest reasonable rate, but actually are the only reasonable rate. Panhandle's and the Commission's intentions that the cost method is flagrantly discriminatory and inimical to the best interests of ultimate consumers are at best specious and not supported by any evidence adduced by them during the proceedings.

Courts and other authorities in the field of utility regulation who have considered the problem are in universal agreement that the cost method is the only equitable basis for both investors and rate payers. They recognize that the cost method results in a return which is neither confiscatory of the investors' property nor exorbitant in charge of the consumers.

The acceptance of the cost method for nearly a quarter of a century by practically every regulatory agency in the United States, including the Commission itself until the instant case, should be proof positive of its ultimate reasonableness. The present attempt by Panhandle to upset the cost method in favor of the "field price" is the cumulative outgrowth of all its prior aborted efforts to exploit rate payers for the sole benefit of stockholders.

In his renowned separate opinion in *Missouri ex rel. Southwestern Bell Tel. Co. v. USC* (1923), 262 U. S. 276 Mr. Justice Brandeis penetratingly set forth the case for the prudent investment doctrine (original cost of facilities

prudently acquired) in terms which have not since been improved upon:

> "I concur in the judgment of reversal. But I do so on the ground that the order of the State Commission prevents the utility from earning a fair return on the amount prudently invested in it."
>
> "The so-called rule of Smyth v. Ames† is, in my opinion, legally and economically unsound. The thing devoted by the investor to the public use is not specific property, tangible and intangible, but capital embarked in the enterprise. Upon the capital so invested the Federal Constitution guarantees to the utility the opportunity to earn a fair return. Thus, it sets the limit to the power of the state to regulate rates. The Constitution does not guarantee to the utility the opportunity to earn a return on the value of all items of property used by the utility, or of any of them. * * *"
>
> "* * * The owner is at liberty, in the absense of controlling statutory provision, to withdraw his property from the public service; and, if he does so, may obtain for it exchange value.* * * *"
>
> "* * * But so long as the specific items of property are employed by the utility, their exchange value is not of legal significance."
>
> "* * * The experience of the twenty-five years since that case *(Smyth v. Ames)* was decided has demonstrated that the rule there enunciated is delusive. * * *"
>
> "* * * To give to capital embarked in public utilities the protection guaranteed by the Constitution, and to secure for the public reasonable rates, it is essential that the rate base be definite, stable, and readily ascertainable. * * *"

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† *Smyth v. Ames* (1898), 169 U. S. 466, which allowed "present fair value" of property as a factor in determining the rate charge.

"* * * the late John M. Eshleman, first president of the California Railroad Commission said: '* * * the cost of doing the business, plus a return upon the capital necessarily invested in the business, which return shall be as great as is offered in other businesses of similar hazard, is all that ought to be accorded for the future, and it is all that will be accorded if the public has any business sense. And if more is asked by the private owner, then he may expect no sympathy when he finds the public his competitor and his earning power impaired.'"

"In adoption of the amount prudently invested as the rate base and the amount of the capital charge as the measure of the rate of return would give definiteness to these two factors involved in rate controversies which are now shifting and treacherous, and which render the proceedings peculiarly burdensome and largely futile. Such measures offer a basis for decision which is certain and stable. The rate base would be ascertained as a fact, not determined as matter of opinion. It would not fluctuate with the market price of labor, or materials, or money. It would not change with hard times or shifting populations. It would not be distorted by the fickle and varying judgments of appraisers, Commissions, or courts. It would, when once made in respect to any utility, be fixed, for all time, subject only to increases to represent additions to plant, after allowance for the depreciation included in the annual operating charges. * * *"

In recent years, various state utility commissions have made the following observations with respect to the original cost doctrine:

"* * * the Board deems it appropriate to base its findings as to rate base largely upon evidence in the record as to average net plant investment. This appears reasonable not only because of the infirmities in the Company's current cost estimate heretofore pointed out but because of the inherent reason-

ableness of using actual investment as a measure of rate base. Utilities are not able to pick and choose the periods when they will install plant. If the servicing of the public requires the installation of additional facilities, the utility may not defer the investment merely because price levels appear high. * * *" N. J. Board of PUC, *re N. J. Bell Tel. Co.* (1947) 72 PUR (NS) 37, 49.

"* * * The company urged that the return to its investors should reflect the changes in purchase value of their dollars and that a return upon a reproduction-cost-new rate base merely achieves this end result.

"We cannot accept this position of the company. Reproduction cost new as the sole determinate of fair value of utility property has no foundation in the law or in the equities of rate regulation. It is not generally reliable or equitable for the purpose of determining fair and reasonable rates. The determination of fair value of utility property requires a consistent standard, whereas reproduction cost new involves consideration of continuously changing values and affords no such standard. Furthermore, it is not realistic. It does not represent an actual outlay of money by investors; and, it attempts to attach a value of property determined under competitive conditions in the sale of its products to property devoted to public use under regulated monopolistic conditions. Nor, does it merely reflect the change in purchase value of investors dollars. Since the cost of bond money and preferred equity are fixed, the resulting increment or decrement in return falls wholly upon the common stockholders with corresponding inequities of excess or deficiency."

"After the consideration of all the testimony and exhibits in the case, and carefully analyzing the evidence, we find the fair value of petitioners property devoted to its natural gas department to be represented by the original cost rate base developed by the Commission staff. * * *"

"* * * This rate base, in our opinion, affords a proper measure of the actual dollars of net investment in the natural gase operations of Consumers Power Company and is a proper basis upon which to compute the necessary revenues for the company. * * *" Mich. PSC, *re Consumers Power Co.* (1949), 78 PUR (NS) 315, 326.

"The Commission is of the opinion that a rate base predicated upon net average investment ascertained from original cost, less accrued depreciation, plus allowance for working capital, is fair to the Utility, its investors, and consumers or subscribers, and gives recognition to every dollar invested in the property used and useful in rendering the public service." Fla. RR and PUC, *re Southern Bell T. & T. Co.* (1949), 80 PUR (NS) 161, 170.

"* * * The adoption of the above original cost depreciated value as a rate base is consistent with the Commission's determination in the earlier fare case and also with the Commission's policy of using prudent investment less accrued depreciation as a fair rate base. This basis of value appears reasonable and proper, both to the Company and to the public and will be used in the determinations in this case." Ga. PSC, *re Georgia Power Co.* (1949), 81 PUR (NS) 240, 242.

"We adhere to the traditional Massachusetts theory of prudent investment.

"Stated tersely, 'it is the money honestly and prudently invested and devoted to the public service that is entitled to earn a fair return. * * *.'

"The clearest, as well as the best-known exposition of the Massachusetts theory of prudent investment was that of the late Justice Brandeis in his separate opinion in the Southwestern Bell Telephone Case, in which he called attention to the factor of stability of the rate base brought about and accomplished by the use of the prudent investment

theory." Mass. Dept. of PU, *re New England T. & T. Co.* (1949), 83 PUR (NS) 238, 271.

"In the Uniform System of Accounts prescribed by the Federal Communications Commission, Federal Register, Volume 13, No. 105, dated May 28, 1948, §31.100:1, Telephone Plant in Service is defined: 'This account shall include the original cost of the company's property used in telephone service * * *' This method of considering Telephone Plant in Service, which is predicated upon the actual money cost of the property at the time when it was first dedicated to public use, constitutes in our judgment the most equitable method available for achieving a just determination of the rate base. * * *" Vt. PSC, *re New England T. & T. Co.* (1950), 83 PUR (NS) 414, 430.

"*Original Cost Less Depreciation.* The Commission has found from the evidence that the original cost less depreciation rate base of the company in the year 1951 will approximate the sum of $8,088,000.

"It has been the view of the Commission for some time that in rate-making matters this type of base is most acceptable to it in performing its dual function of protecting the investors of regulated telephone utilities and their subscribers; and thus we feel it unnecessary to elaborate further upon the subject, except to say that the Commission still adheres to this view." Wyo. PSC, *re Mountain States T. & T. Co.* (1951), 89 PUR (NS) 341, 439.

"This Commission holds to the theory that the cost of plant, when first devoted to public use, represents the most acceptable value for rate-making purposes, * * *" La. PSC, *ex parte Westside Transit Lines, Inc.* (1951), 91 PUR (NS) 56, 57.

"We have selected as our approach in the determination of a just end result the use of an

> original cost, or an investment rate base," the supreme court of Florida recently said in *Jacksonville Gas Corp. v. Railroad & Public Utilities Commission* (1951), 50 So. (2d) 887, 893. "* * * But from a view of the whole situation, we are convinced that fairness and reasonableness may be meted out to consumer and investor by gauging the amount the latter is to receive on the basis of the 'actual cost,' a figure which obviously is more accurate than 'present value' based on estimate, and more stable when value is so affected by changing conditions, and that these changes may be compensated from time to time by varying the percentage of return so that the holder of a share of stock will receive an amount to which he is at the time fairly entitled."

To the same effect see *Southwestern Bell Teleph. Co. v. State* (1951), 230 P. (2d) 260.

Original cost or investment is a fact which is readily ascertainable. In this case it is not in dispute. Reproduction cost or a "fair value" rate base is always a matter of controversy between the experts. As Justice Stone said in 1935:

> "In assuming the task of determining judicially the present fair replacement value of the vast properties of public utilities, courts have been projected into the most speculative undertaking imposed upon them in the entire history of English jurisprudence." (Dissent, concurred in by Justices Brandeis and Cardozo in *West v. Chesapeake & P. Teleph. Co.*, 295 U. S. 662.) "Rate cases of this importance require vast preparation, are lengthy to try, and involve enough technical questions without enlarging the field of controversy."
>
> "* * * The investment cost does not change. The investors in the company's securities can tell what the balance sheet shows as to the amount of the company's investment or cost of plant. The in-

vestor knows that in times of inflation or deflation the amount is fixed. He has no such guide if the company's assets are to be revalued from day to day.

"There are many theoretical reasons which have been cited by the experts for the use of an original cost rate base some of which seem to us compellingly to urge its use. However, if for no other reason, the practical aspects of a speedy determination of a rate case and of reducing the number of unknown factors to the greatest possible degree leads us to the unqualified conclusion that the policies followed by this Commission in the past have been correct; and that we can reach a just and equitable result—and certainly a speedier one—by adhering to the principles this Commission has followed without challenge by the courts.

"One argument advanced by the company deserves comment, that we are in a period of inflation; that the cost of replacing the property is more than its original cost and that the effect on investors will be to discourage them from putting their money in utilities where the original cost rate base is used. This is based upon the assumption that in fixing rates consideration has not been given to the force of inflation or the decreasing purchasing power of the dollar. The adoption of a replacement cost rate base, it is argued, would be a clear indication that regulatory Commissions recognize that impact. However, one of the vice presidents of the telephone company testified that it was immaterial, so long as it was made clear to investors that regulatory Commissions did recognize the impact of inflation, whether it was done by adopting the type of rate base argued for by the company or by considering that matter in the rate of return." N. Y. PSC, (1951), *re N. Y. Telephone Co.,* 91 PUR (NS) 231, 256.

"Since the Commission has just recently (April 9, 1952) passed upon the rate base standard in the *Wisconsin Telephone Case, supra,* (93 PUR (NS) 490) we repeat below the relevant parts of that opinion:

" 'The issue as to proper valuation of property for rate-making purposes has a long history of controversy since the historic decision of the United State Supreme Court in Smyth v. Ames (1898), 169 U. S. 466, 42 L. ed. 819, 18 S. Ct. 418. From 1898 and until the United States Supreme Court decision in Federal Power Commission v. Hope Nat. Gas Co. (1944), 320 U. S. 591, 88 L. ed. 333, 51 PUR (NS) 193, 64 S. Ct. 281, regulatory Commissions were urged to apply various and often inconsistent thories of valuation depending upon the prevailing price levels. If original costs were higher than the general price levels, the utilities then persuaded some Commissions and courts to adopt the original cost theory of valuation; if the general price level at the time of a rate case were higher than original costs, then contrary theories were urged by the utilities and often adopted. A single consistent valuation theory thus seemed impossible of attainment.

" 'Traditionally, this Commission has long espoused the investment cost method of establishing the rate base. See *Waukesha Gas & E. Co. v. Railroad Commission,* 181 Wis. 281, 301, PUR 1923E 634, 194 NW. 846. Since the Hope Case, this Commission has considered that it is completely free to rely exclusively on the investment cost standard, so long as the rate of return applied to that standard achieved the required reasonable end result. This has been recognized as the law in Wisconsin long before the United State Supreme Court decided the Hope Case in 1944.' " Wis. PSC, *re Wisconsin Electric Power Co.* (1952), 93 PUR (NS) 97, 101.

In an address before the New York Society of Security Analysts in New York City on October 8, 1952, former FPC Chairman Thomas G. Buchanan made the following statements:

> "* * * Suffice it to say that the standards under which regulation is conducted and which standards we earnestly strive to maintain is an honest and unbiased approach to the balancing of the consumer and investor interests for the general public good. While we may at times be accused of being 'anti-business' those charges, when made, invariably spring from the fact that sound business judgment has caused us to resist the appeal of some pet scheme designed to operate selfishly and not for the public good. * * *"
>
> "* * * since we are dealing with monopoly, it is axiomatic that there should be a reasonable return on the dollars invested in the project but, that there should be little, if any, relationship between such return and speculative profits."
>
> "* * * our approach to rate making is not a creature of our own devising, but follows the standard of the Brandeis dissent in the Southwestern Bell case, and the decisions in the Bluefield Water case, and the Hope Natural Gas case, ranging from the early 1920's to 1943. * * *"
>
> "It is well known that the Commission in determining just and reasonable rates employs what is called a net investment rate base. Broadly speaking, the net investment rate base consist of cost of properties used and useful in the public service, less accrued depreciation, with a reasonable allowance for required working capital. The Commission has used this method in all except its interim order in the Natural Gas Pipeline rate case, 1940, and the method was fully sustained by the Supreme Court in the *Hope Natural Gas Company* case and other proceedings. The method is used widely through-

> out the United States, being employed by more commissions than any other rate base method. It is employed, for instance, by the Public Service Commision of New York."

Text writers have also deemed it appropriate to expound favorably on the merits of the original cost doctrine. Professor I. R. Barnes at page 413 of his book, "The Economics of Public Utility Regulation" (F. S. Crofts & Company, New York, 1947) groups the advantages of the original cost doctrine into 3 basic categories, namely:

> "* * * * administrative efficiency in regulations, financial stability for the enterprise and its investors, and the maintenance of equitable relations between the patrons and the company."

Professor Barnes claims that the relative ease with which regulatory commissions may determine original cost "is a legitimate reason for the preference which commissions have shown for this measure of the rate base". Revisions in original cost figures need be made only infrequently as opposed to the reproduction cost estimates which must be revised whenever a change in general price levels occurs. Once original costs have been determined subsequent revisions involve merely a consideration of subsequent net capital additions and retirements. The possibility of litigation is greatly minimized and "fantastic distortions in the rate base due to the changeable and subjective judgments of valuation experts, commissions, and courts, are also largely avoided".

Original cost, according to Professor Barnes, is not subject to the wide fluctuations inherent in reproduction cost estimates. This adds to the financial stability of utilities and tends to lower the cost of capital and to re-

duce the expense of service. Utilities are largely financed with debt capital. Any substantial decrease in the rate base in a period of declining prices to a point below the original cost figure may render the utility unable to meet its fixed charges upon the debt capital.

Professor Barnes states that full justice is done to bondholders and preferred stockholders if the utility's earnings continue to cover their contractual interest and dividend payments. If justice requires greater payments to common stockholders during periods of inflation a greater rate of return can be provided without deviating from the original cost method of fixing the rate base.

In evaluating the various methods of rate base determination, Professor Clemens in his book "Economics and Public Utilities," (Appleton-Century-Crofts, Inc., N. Y., 1950) at pages 183-188 concludes that the adoption of the original cost rate base method, "cannot help but be a gain for regulation."

At page 152 of his book Professor Clemens criticizes the claim that the cost of reproduction doctrine tends to provide utility investors with an income of constant purchasing power. Professor Clemens states that neither debt capital investors nor equity capital investors would receive an income of fixed purchasing power. Bondholders would receive the same monetary income regardless of any change in the rate base. In times of inflation the relatively small group of stockholders would obtain the total additional income resulting from the upward revaluations of the utility's property which would be substantially more than they would be entitled to in theory. During a decline in prices, however, the stockholders might not only suffer a loss in purchasing power but their entire income from their investment in the utility might be destroyed.

Professor Clemens also concludes that constant purchasing power of common stockholders can be attained more readily by means of varying the rate of return rather than the rate base.

In summarizing his evaluation of the relative merits of original cost versus reproduction cost methods of valuing utility property, Professor Clemens makes the following statements at pages 157 and 158 of his book:

> "The weight of disinterested authority has been strongly against both the (Smyth) rule and its corollary, that fair value means present value. * * *"

> "The choice seems to lie with some form of original cost. It is equitable in theory and relatively easy to determine. Once determined, it may be recorded on the books of the utilities and becomes available with a minimum of effort. It safeguards the interests of investors and rate-payers alike.

> "Two important points remain to be stressed. A fixed and stable rate base does not necessarily imply a return that is completely inflexible. Adjustments can and should be made in the rate of return rather than in the rate base. Second, it must be pointed out that the acceptance of original cost does not mean that all costs must be included in the rate base. Original cost may be modified for imprudent investments. * * *"

From the foregoing, it can be readily seen that until its Opinion No. 269, the Commission had refused to recognize the field price theory of gas valuation on the grounds that it did not represent a "fair" and "just" rate, nor the *"lowest reasonable rate"* within the meaning of the Natural Gas Act. Nor had the Commission ever allowed any profit to utility investors other than a fair return on the original cost of property devoted to public service

in accordance with the principles espoused by Mr. Justice Brandeis in his judicious *Southwestern Bell* opinion.

Inclusion in the rate making formula of a field price for gas produced by a regulated pipe line company would provide to the common stockholders of such company an unearned windfall which can approach startling magnitudes. For example, an allowance of the field price of gas obtained by independent producers in an unregulated market would provide for the owners of the common stock of Panhandle an unearned monetary appreciation in its 3.5 trillion cubic feet of gas reserves amounting to $455,000,000 (based upon the field price of 13¢ per Mcf contained in Panhandle's Annual Report). Debt and senior equity capital owners, being entitled to only a fixed contract rate of return would be excluded from participation in the fruits of this write-up. The gas consuming public not only would not share in the spoils but would be the hapless provider thereof.

**The Action of the Federal Power Commission in Fixing Rates for a Natural Gas Company Must Not Be Arbitrary Nor Produce an Arbitrary Result**

In *F. P. C. v. Natural Gas Pipeline Co.*, 315 U. S. 575, the United States Supreme Court stated, at page 586, that the Court's inquiry into a Commission rate order is at an end *if* the Commissioners have acted "*within the ambit of their statutory authority*" and "*if* the Commission's order, as applied to the fact before it and viewed in its entirety, *produces no arbitrary result* * * *."

*F. P. C. v. Natural Gas Pipeline Co., supra*, was the first major natural gas pipeline rate case to reach the United States Supreme Court in the Commission's administration of the Natural Gas Act. The Commission in this

case had *disallowed* the pipeline company's claim for "*going concern value*" on the ground that "*it is an arbitrary claim* * * *. Its allowance would mean the acceptance of a *deceptive fiction, resulting in an unfair imposition upon consumers.*"

The Supreme Court upheld the Commission's order, including its disallowance of the claimed item for going concern value, stating that this claim was based upon "*synthetic figures.*"

In the *Hope* case, *supra,* the Commission had rejected the pipeline company's evidence with respect to *present value* of its jurisdictional properties on the ground that "it is *not predicated upon* facts and that it is too *conjectural and illusory* to be given any weight in these proceedings."

In *Northern Natural Gas Co.,* Docket No. G-1382, *et al.,* Opinion No. 228, decided in 1952, the Commission rejected a claim by the pipeline company for the allowance of an "attribution" price for the pipeline's produced gas, based upon a "*minimum value*" fixed by an order of the Kansas Corporation Commission. The Commission stated:

> "The effect of Northern's contention would be to add a *fictitious* $1,914,574 to Northern's actual cost of service.
>
> "Northern does not, and of course could not, claim that the $1,914,574 will be incurred by it or that it represents cost. Nor does Northern contend, that disallowance of the claimed value would be confiscatory. Neither does Northern contend, nor has it attemped to show, that *sound economic reasons* exist for a departure from an actual cost of service basis for fixing just and reasonable rates." (Emphasis supplied.)

This finding was affirmed in *Kansas State Corporation Commission v. F. P. C., supra.*

As has been stated hereinbefore, the Commission in the instant case purported to allow to Panhandle for its own gas production the "weighted average *arm's length prices* of gas at the well-head in the fields where this gas is produced." (R. 9746.)

The Commission found that, "*According to the uncontroverted evidence of record, these prices* * * * *were* * * *" (Emphasis supplied):

7.0¢ in Texas
8.4843¢ in Kansas
11.0¢ in Oklahoma

The Commission then increased the Kansas "arm's length" price to 9.4978¢ per Mcf to conform this price to the Kansas Corporation Commission's minimum well-head price orders, and arrived at a "weighted average arm's length price" of 8.4398¢ per Mcf which it allowed to Panhandle for its own produced gas.

Commissioner Draper demonstrated in his dissenting opinion (R. 9871, 9872) that the testimony and exhibits of record reveal that the prices used by the majority for Kansas and Oklahoma production generally represented "the minimum well-head prices prescribed by the Kansas and Oklahoma Commissions rather than the arm's length bargained-for prices." He also pointed out that the majority had given no consideration to whether the Kansas and Oklahoma "field prices" covered purchases of comparable gas in like volumes and under similar terms and conditions.

In his opinion, Commissioner Draper also indicates (R. 9872, 9873) the method employed in arriving at the Texas "arm's length" prices as revealed by the record. The Texas average arm's length price was based upon a *find-*

*ing by the Texas Railroad Commission* of "the current market price" being paid at the wellhead. This finding was, in turn, based upon an exhibit prepared by an employee of Natural Gas Pipe Line Company of America under which only 11½% of the volumes of sales were "valued" pursuant to *contract prices.*

Clearly, the Commission did not even do what it purported to do, it *did not even* base its average arm's length price *primarily* on average arm's length contract prices.

Furthermore, the Commission adhered to *no consistent policy* in finding "arm's length" prices as *among the three producing states considered.*

As though this were not sufficient evidence of unabashed caprice in attempting to arrive at the "value as a commodity" (R. 9745) of Panhandle's own produced gas, the Commission blandly discoursed upon the incongruity of its resultant weighted average price with *various other contract prices extant within a single producing area.*

The Commission's (or Panhandle's )resultant average price of 8.4398¢, said the Commission, is "in excess of the weighted average price (7.7457 cents per Mcf) estimated to be paid by Panhandle during the test year 1952 under its outstanding contracts for gas purchases" with independent producers. (R. 9747)

And, says the Commission, this average price "is well below the rates of royalties concurrently paid by Panhandle to its lessors on its own production" which are 8¢, 9¢ and 11¢. (R. 9747)

"Furthermore," says the Commission, "it is well below" the 9.4¢ to 20.0¢ per Mcf "at which more recent gas purchase contracts have been negotiated." (R. 9747).

At the outset of its opinion, the majority declared that it was going to let Panhandle charge for its own produced gas "its value as a commodity." To find the value of Panhandle's gas as a commodity, the Commission looked to some producing state well-head price orders and a self-serving statement of another natural gas pipeline company and miraculously extracted therefrom the "weighted average arm's length prices of gas." Then the Commission adduced a profusion of other prices which it might have used, but did not use, as the *value* of Panhandle's natural gas *as a commodity.*

Respondent respectfully submits that Panhandle's own gas can, at any one time, have *but one value* as a commodity for the use which Panhandle makes of such gas.

That the Commission believes Panhandle's gas may have any number of values, and that the Commission believes it may select any one of such values, subject only to its whims and fancies, is aptly demonstrated by the Commission's own characterization of its final computation as:

> "*this conservative measure of the commodity value* of the gas which Panhandle produces." (R. 9748, emphasis supplied.)

If the Commission may lawfully hand out to Panhandle (from the ratepayers' till) an amount to cover the *value* of Panhandle's own gas *as a commodity,* what is to prevent the Commission in the next Panhandle rate hearing from granting that company a commodity value of 20¢—the price at which recent contracts have been negotiated?

If the "commodity value" theory is sound in principle at all, then it must be sound when carried to its (il)logical extreme.

The Commission apparently endeavors to justify its use of the commodity value theory by taking great pains to

show that it has allowed Panhandle a much smaller commodity value than it could have allowed.

The Commission is informing the ratepayer that it has rapped him soundly upon his head, but with ostentatious magnanimity admonishes him to be grateful that it has not fractured his skull.

The Commissions' approach not only fails to serve as justification for, but actually emphasizes, the extreme degree of its arbitrariness.

**Approval of the Commodity Value Doctrine Will Open the Door to Panhandle to Obtain Inordinate Profits**

If this Honorable Court deems it appropriate to cast aside the basic concept of utility rate regulation, that the utility investor is entitled to no more than a fair return on its investment in return for the relative security thereof, and if this Court sanctions this *bizarre* form of "regulation," then it may rest assured that it will have opened the door wide enough for Panhandle to plant its immutable foot on the threshold of the path to the *higest* commodity value allowance for its own gas production.

As Commissioner Draper stated in his dissent (R. 9874):

> "Panhandle's counsel conceded that his client was not pressing for the maximum prices that might very well be claimed in a case of this kind (T. 13893)." (R. 4720)

There is no need for conjecture regarding this assertion. The facts speak for themselves.

On June 30, 1954—almost before the ink was dry in Opinion No. 269—Panhandle was back before the Commission in Docket No. G-2506 *requesting a rate increase.*

In Opinion No. 269, the Commission allowed to Panhandle a commodity value of 8.4398¢ per Mcf at a pressure base of 16.4 pounds per square inch.

In Docket No. G-2506, *Panhandle requested for its own produced gas* 10.4178¢ per Mcf on a pressure base of 14.65 pounds per square inch, which amounts to *11.6622 per Mcf* at 16.4 pounds. (Exhibit 1, Statement A. Schedule 2, p. 1 in Docket G-2506.)

Panhandle's new rate schedules went into effect January 1, 1955 pursuant to the Commission's order in Docket No. G-2506, adopted December 8, 1954 and issued December 13, 1954.

As was recognized by both the majority (R. 9740) and Commissioner Draper (R. 9872) the Kansas minimum well-head price has been increased by approximately 3¢ per Mcf, effective January 1, 1954. This alone would add another million dollars to Panhandle's profits.

The uncontrollable fluctuations to which the Commission's method subjects commodity value leave no doubt as to the arbitrary nature of this form of attempted regulation, and clearly indicate that the *spread* between *value* and *cost* will steadily increase, to the ultimate joy of pipeline company stockholders and despair of the ratepayer.

Any allowance by the Commission to Panhandle for its own gas which is *in excess of the cost* to Panhandle of producing such gas, obviously is a grant of nothing less than *profits* to Panhandle.

The Commission stated that the net results of its adoption of the commodity value doctrine required the ratepayers to provide Panhandle with an *additional revenue of $3,571,448 per year* on the basis of the test year 1952.

As of December 31, 1952, bondholders had contributed over $121,000,000 to Panhandle's capital. According to Panhandle's annual reports to its stockholders, these bondholders receive for their investment pursuant to the terms of their bonds, *fixed rates of interest* ranging from 1.7% to

3.25%. The bondholders' return on their investment in Panhandle is not increased by one farthing of the added profits granted to Panhandle by the Commission.

On the other hand, the *stockholders* who, as of the same date, had contributed only approximately $21,000,000 to Panhandle's capital, may receive *any portion or all of such increased profits within the sole discretion of Panhandle's board of directors.*

It bears repetition at this point that the *consumer*, not only *fails to share* in these spoils, but *is compelled to be the hapless provider thereof.*

That conventional rate-base, rate-regulatory policies provide ample and objectively measurable and controllable means for protecting and attracting capital has already been demonstrated herein.

Surely the *result* of the Commission's action in this case is as *arbitrary* as the Commission's *method.*

As Commissioner Draper stated in his opinion (R. 9878), the Commission, rather than prescribing a standard for determining the "value as a commodity" of a pipeline company's own gas production, merely *allowed to Panhandle what Panhandle requested.* Elsewhere in his opinion, however, Commissioner Draper cites other recent natural gas company rate cases in which the Commission did not insist upon an abandonment of orthodox principles with respect to the pipelines' own gas production. (R. 9877).

If the commodity value theory is the *only* panacea for this gas-producing pipeline company's ills, then obviously it *must* be adopted as to all pipeline companies *without discrimination*—unless, of course, the Commission is disposed to be *arbitrary.*

As has been iterated hereinbefore, the Commission would now require the consumers to pay Panhandle for the gas

produced by Panhandle, its greatly inflated value as a commodity, *notwithstanding the fact that the consumer has underwritten Panhandle's producing operations with capital contributions* in the form of prior *annual* rate allowances to Panhandle for *exploratory costs*, abandoned leases, delay rentals and non-productive drilling and for the *annual depreciation* on its producing facilities.

If this is not arbitrariness at its height, then "reasonableness" has transcended all bounds of reason.

The Commission would obliterate our insight into this problem with a recitation of Mr. Justice Jackson's decrial of the "delirious results produced by the rate-base method" of treating a pipeline company's own gas production. (R. 9757)

It should, however, be clear beyond a scintilla of doubt that the Commission, by virtue of its remarkable conduct in this case, has placed itself in no position to hurl stones chipped by a single Justice from the pillars of reason and convention.

**Both the Commission and the Courts Have Heretofore Unequivocally and Without Exception Treated Gasoline and Hydrocarbon Profits as a Factor in Production Costs Under the Rate Base Method**

Throughout the administrative proceedings of this case, the Respondent and others, including the Commission's own Staff, have contended that Panhandle's extraction of liquid hydrocarbon from the gas stream was a by-product of Panhandle's pipeline operations and that such extraction was incidental to the transportation and sale of natural gas. In harmony with this contention, the Staff, in its brief included in Panhandle's net investment base rate the average of Panhandle's stipulated investment in the amount of $679, 876 in plant devoted to the extraction of the liquid

hydrocarbons. Additionally, the Staff included in its cost of service a credit to production operations for residual extractions of $1,853,827, the net revenue from the hydrocarbon sales.

This treatment of the gasoline plant net revenues as a credit to natural gas operations had heretofore been followed by the Commission in numerous cases, notably among which were, *In the matter of Hope Natural Gas Company* (1942), 3 F. P. C. 150, 178; *City of Detroit v. Panhandle Eastern Pipe Line Company* (1942), 3 F. P. C. 273, 289; *In the matter of Cities Service Gas Co.* (1943), 3 F. P. C. 459, 580; *City of Columbus, Ohio, v. United Fuel Gas Company* (1946), 5 F. P. C. 279, 290; *In the matter of United Fuel Gas Company,* Dockets No. G-1781, G-2055, Opinion No. 258 issued August 7, 1953.

The Commission's past treatment of gasoline plant net revenues as a credit to natural gas operations was in accord with that which for years has been the standard regulatory treatment of by-product revenues from utility operations. Even as far back as 1917, in dealing with revenues available from the sale of coke and tars resulting from manufactured gas operations, the revenues were credited to reduce the manufacturing costs. In this connection, Respondent directs the Court's attention to *Re Uniform System of Accounts, New York Public Service Commission, First District,* PUR 1917D, 122, 138; *Green Bay v. Wisconsin Public Service Company,* PUR 1922B, 671, 679; *Re Wisconsin Gas and Electric Company,* PUR 1922C, 829, 836; *Re Wisconsin Minnesota Light and Power Company,* PUR 1922D, 131, 136; *Re Great Falls Gas Company,* PUR 1922D, 385, 436.

Panhandle contends that the formula heretofore followed by the Commission resulted in a negative return for the gas produced from its own well-heads (R. 8802). This was accepted at face value by the majority in Opinion 269.

The analysis made by the Staff, however, knocked this contention squarely on the head, as pointed out by Commissioner Draper in his dissent:

> "The majority accepts and is impressed by Panhandle's claim that our cost of service method would allow a net return of less than nothing for Panhandle's own produced gas. The staff's cost of service was prepared in accordance with Commision policies and precedents established in prior cases. It is summarized by functional classifications in Exhibit 550, Schedule B-1-R. (R. 8595). That portion of the total cost of service applicable to company-owned production, under the heading 'Wellhead' costs, is broken down as follows:
>
> | | |
> |---|---|
> | "Production expenses | $1,217,656 |
> | Exploration and development costs | 595,000 |
> | Administrative and general expenses | 145,161 |
> | Depreciation, depletion and amortization | 548,263 |
> | Taxes—Other than federal income. | 269,799 |
> | Return at 6% | 623,286 |
> | Total | $3,399,165 |
>
> "These wellhead costs were included in the total cost of service and an allocable portion thereof assigned to jurisdictional business.
>
> "The total gas produced in 1952 by Panhandle (Company estimate) was 73,005,344 Mcf at 16.4 pounds (Exhibit 550, Schedule B-4c-R). Thus, each Mcf of gas produced carried a cost, including return, of 4.656¢ at the wellhead. That figure is the average production cost. Even if this cost of production were reduced by the liquid hydrocarbon extraction revenues (net) of $993,306 claimed by Panhandle to be applicable to produced gas, and by the $537,524 claimed reduction in tax liability resulting from the 27½% statutory depletion allowance, the resulting average production cost would be 2.56¢ per Mcf, which is still not a negative figure.

> "These figures speak for themselves. But the majority opinion in and of itself clearly demonstrated that Panhandle's claim that under the rate-base method it receives a negative allowance of -1.24¢ at the wellhead for each Mcf of gas which it produces, is fallacious. At page 14 of their opinion the majority show that the total difference between their allowance for produced gas of $5,476,804 (64,-451,518 Mcf at 8.4976¢) and the cost of produced gas under the rate-base method including a return at 5¾% is $4,169,052. This means, of course, that the rate-base method will not provide 'less than nothing' because it is clear that the difference between these two figures is a positive amount; it is impossible to deduct a negative amount from $5,-476,804 and get $4,169,052." (R. 9875-9876).

The majority opinion also concedes (R. 9774) that the Commission has "unquestioned jurisdiction" of the gasoline extracting facilities of Panhandle. Yet after making this statement, it proceeds to make no allowance for the profits derived from these operations in the rate base, treating it for all intents and purposes, as a separate business over which it had no jurisdiction!

In determining the reasonableness of the rate of a natural gas company under the Natural Gas Act, the Court of Appeals for the Eighth Circuit said in *Mississippi River Fuel Corporation v. F. P. C.* (1941), 121 Fed. (2nd) 159, 40 PUR (NS) 213:

> "It appears from the credit provisions of the Act that the permitted rates are to be subjected to the test of a fair investment return on the natural gas companies' *property as a whole.*" (Emphasis supplied.)

Respondent submits that the consensus of judicial authority is that it is enough that an investor in a regulated utility get a fair return on his property as a whole, and that he is to be granted no special exemption for any segment thereof in determining the reasonableness of his return.

## CONCLUSION

For the reasons stated, the Respondent prays that this Honorable Court deny the Writ of Certiorari prayed for by Petitioners, Panhandle Eastern Pipeline Company and Federal Power Commission, in the above cases and affirm the judgment of the United State Court of Appeals for the District of Columbia Circuit.

Respectfully submitted,

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## APPENDIX

Material portions from the Natural Gas Act (15 U. S. C. Sections 717-717w, 52 Stat. 821):

"Section 1(a). As disclosed in reports of the Federal Trade Commission made pursuant to S. Res. 83 (Seventieth Congress, first session) and other reports made pursuant to the authority of Congress, it is hereby declared that the business of transporting and selling natural gas for ultimate distribution to the public is affected with a public interest, and that Federal regulation in matters relating to the transportation of natural gas and the sale thereof in interstate and foreign commerce is necessary in the public interest.

"Section 1(b). The provisions of this Act shall apply to the transportation of natural gas in interstate commerce, to the sale in interstate commerce of natural gas for resale for ultimate public consumption for domestic, commercial, industrial, or any other use, and to natural-gas companies engaged in such transportation or sale, but shall not apply to any other transportation or sale of natural gas or to the local distribution of natural gas or to the facilities used for such distribution or to the production or gathering of natural gas."

"Section 4(a). All rates and charges made, demanded, or received by any natural-gas company for or in connection with the transportation or sale of natural gas subject to the jurisdiction of the Commission, and all rules and regulations affecting or pertaining to such rates or charges, shall be just and reasonable, and any such rate or charge that is not just and reasonable is hereby declared to be unlawful."

"Section 5(a). Whenever the Commission, after a hearing had upon its own motion or upon complaint of any State, municipality, State commission, or gas distributing company, shall find that any rate, charge, or classification demanded, observed, charged, or collected by any natural-gas company in connection with any transportation or sale of natural gas, subject to the jurisdiction of the Commission, or that any rule, regulation, practice, or contract affecting such rate, charge, or classification is unjust, unreasonable, unduly discriminatory, or preferential, the Commission shall determine the just and reasonable rate, charge, classification, rule, regulation, practice, or contract to be thereafter observed and in force, and shall fix the same by order: Provided, however, That the Commission sahll have no power to order any increase in any rate contained in the currently effective schedule of such natural-gas company on file with the Commission, unless such increase is in accordance with a new schedule filed by such natural-gas company; but the Commission may order a decrease where existing rates are unjust, unduly discriminatory, preferential, otherwise unlawful, or are not the lowest reasonable rates."

"Section 6(a). *The Commission may investigate and ascertain the actual legitimate cost* of the property of every natural-gas company, the depreciation therein, and, when found necessary for rate-making purposes, other facts which bear on the determination of such cost or depreciation and the fair value of such property. (Emphasis supplied.)

"Section 6(b). Every natural-gas company upon request shall file with the Commission an inventory of all or any part of its property and a statement of the original cost thereof, and shall keep the Commission informed regarding the cost of all additions, betterments, extensions and new construction."

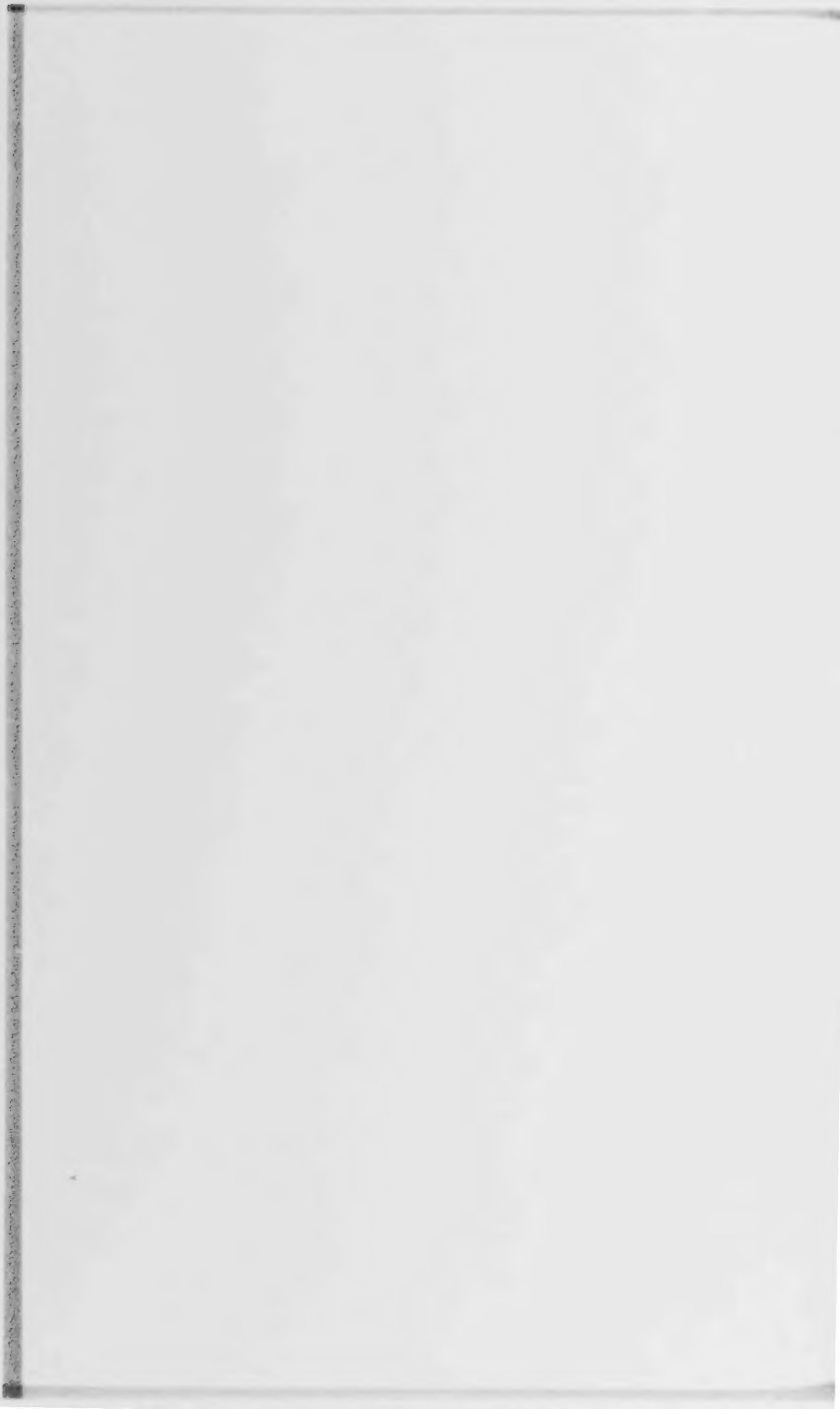
"Section 7(c). No natural-gas company or person which will be a natural-gas company upon completion of any proposed construction or extension shall engage in the transportation or sale of natural gas, subject to the jurisdiction of the Commission, or undertake the construction or extension of any facilities therefor, or acquire or operate any such facilities or extensions thereof, unless there is in force with respect to such natural-gas company a certificate of public convenience and necessity issued by the Commission authorizing such acts or operations: Provided, however, That if any such natural-gas company or predecessor in interest was bona fide engaged in transportation or sale of natural gas, subject to the jurisdiction of the Commission, on the effective date of this amendatory Act, over the route or routes or within the area for which application is made and has so operated since that time, the Commission shall issue such certificate without requiring further proof that public convenience and necessity will be served by such operation, and without further proceedings, if application for such certificate is made to the Commission within ninety days after the effective date of this amendatory Act. Pending the determination of any such application, the continuance of such operation shall be lawful.

"In all other cases the Commission shall set the matter for hearing and shall give such reasonable notice of the hearing thereon to all interested persons as in its judgment may be necessary under rules and regulations to be prescribed by the Commission; and the application shall be decided in accordance with the procedure provided in subsection (e) of this section and such certificate shall be issued or denied accordingly: Provided, however, That the Commission may issue a temporary certificate in cases of emergency, to assure maintenance of adequate service or to serve particular customers, without notice of hearing, pending the de-

termination of an application for a certificate, and may by regulation exempt from the requirements of this section temporary acts or operations for which the issuance of a certificate will not be required in the public interest."

"Section 19(b). Any party to a proceeding under this Act aggrived by an order issued by the Commission in such proceeding may obtain a review of such order in the circuit court of appeals of the United States for any circuit wherein the natural-gas company to which the order relates is located or has its principal place of business, or in the United States Court of Appeals for the District of Columbia, by filing in such court, within sixty days after the order of the Commission upon the application for rehearing, a written petition praying that the order of the Commission be modified or set aside in whole or in part. A copy of such petition shall forthwith be served upon any member of the Commission and thereupon the Commission shall certify and file with the court a transcript of the record upon which the order complained of was entered. Upon the filing of such transcript such court shall have exclusive jurisdiction to affirm, modify, or set aside such order in whole or in part. No objection to the order of the Commission shall be considered by the court unless such objection shall have been urged before the Commission in the application for rehearing unless there is reasonable ground for failure so to do. The finding of the Commission as to the facts, if supported by substantial evidence, shall be conclusive. If any party shall apply to the court for leave to adduce additional evidence, and shall show to the satisfaction of the court that such additional evidence is material and that there were reasonable grounds for failure to adduce such evidence in the proceedings before the Commission, the court may order such additional evidence to be taken before the Commission and to be adduced

upon the hearing in such manner and upon such terms and conditions as to the court may seem proper. The Commission may modify its findings as to the facts by reason of the additional evidence so taken, and it shall file with the court such modified or new findings, which if supported by substantial evidence, shall be conclusive, and its recommendation, if any, for the modification or setting aside of the original order. The judgment and decree of the court, affirming, modifying, or setting aside, in whole or in part, any such order of the Commission, shall be final, subject to review by the Supreme Court of the United States upon certiorari or certification as provided in sections 239 and 240 of the judicial Code, as amended (U. S. C., title 28, Sec. 346 and 347)."



JUN 20 1956
HAROLD B. WILLEY, Clerk

IN THE

# SUPREME COURT OF THE UNITED STATES

**OCTOBER TERM, 1955**

~~(Nos. 958 and 970)~~

No. [redacted]98

PANHANDLE EASTERN PIPE LINE COMPANY,
*Petitioner,*

vs.

CITY OF DETROIT, MICHIGAN, AND COUNTY OF WAYNE, MICHIGAN,
*Respondents.*

No. [redacted]113

FEDERAL POWER COMMISSION,
*Petitioner,*

vs.

CITY OF DETROIT, MICHIGAN, AND COUNTY OF WAYNE, MICHIGAN,
*Respondents.*

ON PETITION FOR A WRIT OF CERTIORARI TO THE UNITED STATES COURT OF APPEALS FOR THE DISTRICT OF COLUMBIA CIRCUIT

## BRIEF FOR RESPONDENT, CITY OF DETROIT, MICHIGAN, IN OPPOSITION

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JUNE 20, 1956.

## INDEX


| | Page |
|---|---|
| Opinions Below | 1 |
| Jurisdiction | 2 |
| Questions Presented | 2 |
| Statutes Involved | 2 |
| Statement | 3 |
| I. Introduction | 3 |
| II. The Commission's Failure to Justify the Allowance of a "Commodity Value" for the Gas Produced by Panhandle | 4 |
| III. The Commission's Treatment of Net Revenues from the Extraction of Liquid Hydrocarbons as Nonjurisdictional | 6 |
| Argument: | |
| I. The Case Does Not Merit Review By This Court | 8 |
| A. The Decision of the Court of Appeals is not Dispositive of the Issue of the Commission's Use of the "Commodity Value" Method | 8 |
| B. The Court Below Recognized That a Standard Is Required for Determination of a "Just and Reasonable" Rate | 12 |
| C. The Decision of the Court Below is not in Conflict with the *Hope* and *Natural Gas Pipeline* Decisions of this Court | 13 |
| D. The End Result Test was Correctly Applied by the Court Below | 15 |
| E. The Court has Raised No Issue *Sua Sponte* | 17 |
| II. The Court Correctly Reversed The Commission's Order Treating As Nonjurisdictional The Net Revenues Received By Panhandle From Its Extraction of Liquid Hydrocarbons | 18 |
| Conclusion | 21 |
| Appendix A | 23 |

## CITATIONS

*Cases:*

Page

*Capital Transit Co.* v. *Public Utilities Commission*, 93 U.S. App. D.C. 194, 200-202, 213 F.2d 176, 182-184; *cert. denied*, 348 U.S. 816 ..... 12

*City of Columbus* v. *United Fuel Gas Company*, 5 F.P.C. 279 ..... 19

*Coe* v. *Armour Fertilizer Works*, 237 U.S. 413 ..... 9

*Federal Power Commission* v. *Colorado Interstate Gas Company*, 347 U.S. 492 ..... 17

*Federal Power Commission* v. *Hope Natural Gas Company*, 320 U.S. 591 ..... 9, 13, 15, 16, 19

*Federal Power Commission* v. *Natural Gas Pipeline Company*, 315 U.S. 575 ..... 13, 14

*Haseltine* v. *Central Nat. Bank*, 183 U.S. 130 ..... 9

*In the Matter of Cities Service Gas Company*, 3 F.P.C. 459, 155 F.2d 694, *cert. denied*, 329 U.S. 773 ..... 19

*In the Matter of Hope Natural Gas Company*, 3 F.P.C. 150; 134 F.2d 287 ..... 19

*In the Matter of Northern Natural Gas Company*, 95 PUR (NS) 289; 206 F.2d 698; *cert. denied*, 346 U.S. 922; *reh. den.* 347 U.S. 1022 ..... 5

*In the Matter of Panhandle Eastern Pipeline Company*, 3 PUR3d 396 ..... 2

*Laclede Gas Light Co.* v. *Public Service Commission*, 304 U.S. 399, 400 ..... 8, 9

*Phillips Petroleum Company* v. *State of Wisconsin, City of Detroit, et al.*, 347 U.S. 672 ..... 10

*Saginaw Broadcasting Company* v. *Federal Communications Commission*, 96 F.2d 544, cert. den., 305 U.S. 613 ..... 18

*Summerfield* v. *Civil Aeronautics Board*, 207 F.2d 205-206, *aff'd.*, 347 U.S. 67 ..... 16

*Statutes:*

Natural Gas Act, approved June 21, 1938, c. 556, 52 Stat. 824 ..... 3

Section 1(b) (U.S.C., Title 15, § 771(b)) ..... 3

*Miscellaneous:*

Page

Notice of Proposed Rule Making, Docket No. R-142, Nov. 17, 1954 (Federal Power Commission) ..... 23, 24

Order Terminating Proceeding, Docket No. R-142, December 1, 1955 (Federal Power Commission) ..... 25, 26

IN THE

# SUPREME COURT OF THE UNITED STATES

**OCTOBER TERM, 1955**

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**(Nos. 958 and 976)**

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## No. 958

PANHANDLE EASTERN PIPE LINE COMPANY,
*Petitioner,*

*vs.*

CITY OF DETROIT, MICHIGAN, AND COUNTY OF WAYNE, MICHIGAN,
*Respondents.*

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## No. 976

FEDERAL POWER COMMISSION,
*Petitioner,*

*vs.*

CITY OF DETROIT, MICHIGAN, AND COUNTY OF WAYNE, MICHIGAN,
*Respondents.*

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ON PETITION FOR A WRIT OF CERTIORARI TO THE UNITED STATES COURT OF APPEALS FOR THE DISTRICT OF COLUMBIA CIRCUIT

---

# BRIEF FOR RESPONDENT, CITY OF DETROIT, MICHIGAN, IN OPPOSITION

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## Opinions Below

The opinion of the Court of Appeals is reported at 230 F. 2d 810 and is printed in the Appendix[1] to the Petition filed by Panhandle Eastern Pipe Line Company (some-

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[1] "App. Pan." references herein are to the Appendix printed in Panhandle's Petition.

times hereinafter referred to as Panhandle) at page 1a and in the Appendix [2] to the Petition filed by the Federal Power Commission (sometimes hereinafter referred to as F.P.C. or Commission) at p. 25. The opinion on denial of rehearing is unreported and is printed at App. Pan. 25a and App. F.P.C. 56-57. Opinion No. 269 of the Federal Power Commission is printed in the Joint Appendix at R. 501 *et seq.*,[3] and reported at 3 PUR 3d 396.

## Jurisdiction

The asserted grounds for jurisdiction are set forth in the Petition.

## Questions Presented

1. Should this Court review a decision of the Court of Appeals, remanding for further proceedings before the Federal Power Commission an Order departing from the judicially sanctioned rate-base method and utilizing a "field price" method, on the grounds that the Commission failed to make adequate findings, based upon substantial evidence, that the increase in rates resulting from the "field price" method was "just and reasonable."

2. Should this Court review a reversal by the Court of Appeals of a Federal Power Commission Order holding that net revenues from Panhandle's extraction of liquid hydrocarbon by-products from its gas stream should not be used to reduce the cost of service when the Court of Appeals properly found that said Order was not supported by the reasons assigned and was contrary to prior findings of the Commission.

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[2] "App. F.P.C." references herein are to the Appendix printed in the Commission's Petition.

[3] "R" references herein are to the pages of the Joint Appendix filed with the Court below; copies have been filed with this Court by Petitioner Panhandle.

## Statute Involved

The applicable provisions of the Natural Gas Act, June 24, 1938, c. 556, 52 Stat. 824, 15 U.S.C. Sec. 717 *et seq.* are printed at App. Pan. 27a, 29a and App. F.P.C. 58-63.

## Statement

I. *Introduction.*

Panhandle is a "natural gas company" within the meaning of Section 1(b) of the Natural Gas Act of 1938 (App. Pan. 27a). Panhandle owns and operates a natural gas pipeline through which it transports gas, partly its own production and partly gas purchased from other suppliers, from Texas, Oklahoma, and Kansas to Michigan and intervening states (R. 514-515, 510, 679-708).

Since 1936 Panhandle has sold natural gas to the Michigan Consolidated Gas Company, the sole natural gas distribution company selling natural gas in the City of Detroit, the Detroit metropolitan area and other communities in the State of Michigan. The City of Detroit itself is a large user of natural gas in its governmental activities and is a customer of Michigan Consolidated (R. 10053-7134).

On August 17 and 30, 1951, Panhandle filed with the Federal Power Commission certain rate schedules under Section 4(d) of the Act by which it proposed to effect an over-all increase in the rates charged natural gas utility customers (R. 512). Prior thereto, the Commission had entered upon an investigation of Panhandle's rates under Section 5(a) of the Act and the proceedings were consolidated for hearing and decision.

Following hearings, briefs and oral argument, the Commission on April 15, 1954, issued its Opinion No. 269 entitled "Opinion and Order Fixing Rates" (R. 501-606). Commissioners Draper and Doty dissented and filed dissenting opinions (R. 607-615, 616-646).

Under the Commission's Order Panhandle was authorized to effect an increase in rates of $12,778,864 annually (R. 600).

The City of Detroit appealed said Order to the United States Court of Appeals for the District of Columbia Circuit; and on December 15, 1955, after briefs and argument, the Court of Appeals remanded the Order to the Federal Power Commission on the grounds that it had failed to sustain the use of a so-called "field price" or "commodity value" for produced gas by substantial evidence and adequate findings. It reversed the Commission's treatment of the revenues realized by Panhandle from its extraction operations because the reasons advanced did not support the conclusion. The balance of the Order was affirmed.

After the Court of Appeals granted several stays in order to afford the Federal Power Commission sufficient time to obtain approval by the Solicitor General for the filing of a petition for certiorari, a petition was filed by the Federal Power Commission on May 25, 1956. The Solicitor General of the United States "authorized," but did not affix his signature to, the Petition. Panhandle filed its Petition on May 21, 1956.

II. *The Commission's Failure to Justify the Allowance of a "Commodity Value" for the Gas Produced by Panhandle.*

In granting Panhandle's Petition for an increase in its interstate rates, the Federal Power Commission, in disregard of the recommendation of its own staff, departed from the traditional rate-determination method which it had consistently employed for some fourteen years with judicial sanction and utilized a new and novel method which it termed the "commodity value" or "field price" method. The method which the Commission had theretofore used in determining "just and reasonable" rates for pipeline companies owning producing properties is

termed the "rate base method." Under this method the natural gas reserves in use, natural gas reserves held for future production and gas wells utilized in producing natural gas are included in the rate base of the utility at cost less related reserves for depletion and depreciation. This method also provides for the recovery through rates of all operating expenses, taxes, depletion, and depreciation applicable to production, and the cost of exploration, including the cost of drilling dry holes. In short, the pipeline company obtains reimbursement for all costs and in addition, secures a fair return on its investment. The risks of exploration and development are shouldered by the customers.

The rate-making method employed by the Commission in the instant case with respect to gas produced by Panhandle was entirely different. It included in the allowed operating expenses a "fictitious cost"[4] item of $5,476,804, purporting to represent the "commodity value" of the gas produced by Panhandle. This sum was computed by the application of a so-called "weighted average field price" to the volume of gas produced by Panhandle, such field price being based upon the payment made by pipeline companies to independent producers for the purchase of gas in the field, state minimum price orders and payments to royalty owners. The Commission excluded Panhandle's producing properties from the rate base, and all actual costs associated with such producing properties were excluded from the cost of service (R. 517, 518, 542). In addition, there was substituted for the actual Federal income taxes payable by Panhandle a much higher hypothetical tax allowance (R. 518, 637).

The total result of the Commission's action in valuing Panhandle's produced gas as "an unregulated commodity"

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[4] See, *In the Matter of Northern Natural Gas Company*, 95 PUR (NS) 289; 206 F. 2d 690; *cert. den.* 346 U.S. 922; *reh. den.* 347 U.S. 1022, where the Commission itself employed this same term.

was that the rates which the Commission allowed Panhandle to collect from its customers exceeded by $3,571,448 annually the rates which Panhandle would have been entitled to collect had the Commission adhered to its long-established regulatory method (R. 677).

The Court of Appeals in reversing and remanding the case to the Commission pointed out that the primary aim of the Natural Gas Act was to guard the consumers against excessive rates and held that although the Commission's departure from the traditional rate base method "was not unlawful" such an innovation must not lift the rates above the "just and reasonable" standards of the statute (App. Pan. 8a, 9a; App. F.P.C. 34).

The Court made the further finding that the traditional rate base method must be utilized by the Commission as a basis of comparison and any allowance above that which is required to meet the "end result" test of a "just and reasonable" rate must be justified on the record. (App. Pan. 15a; App. F.P.C. 42).

The Court remanded the case to enable the Commission, if it so desired, to seek to supplement the record and findings so as to show that the increase in rates caused by such allowance is no more than is reasonably necessary for the purposes advanced for such increase. (App. Pan. 16a; App. F.P.C. 43, 44)

III. *The Commission's Treatment of Net Revenues from the Extraction of Liquid Hydrocarbons as Non-jurisdictional.*

In the past the Commission has consistently treated Panhandle's by-product extraction operations, as well as the similar operations of other pipeline companies, as an integral part of the natural gas pipeline business. The Commission has found that it is necessary and proper to credit the cost of service with the net revenue from such operations (R. 545, 546).

In this case the Commission decided to treat the gasoline extraction operations as a separate non-jurisdictional business. It thereupon excluded all revenues and costs applicable to these operations from the cost of service and substituted therefor a credit in the amount of $591,710, purporting to reflect the estimated loss of heating value of the gas from which the liquid hydrocarbons has been extracted (R. 547).

The net result of the Commission's reversal of its long-established and judicially approved policy was to increase the rates to customers by more than $1,000,000 yearly (R. 641).

By confusing and conflicting language the Commission premised its action upon the finding that Panhandle's extraction operations "to the extent that such extraction is not requisite to the preparation of the gas for pipeline transportation—*should be treated as non-jurisdictional.*" (R. 546, emphasis supplied) It said that its decision to treat such operations as a separate business or department did not rest "upon the question of jurisdiction" since it had "unquestioned jurisdiction" (R. 545) with respect to certain facilities used jointly by the gasoline business and the gas transportation business.

Moreover, while the Commission found that the "reduction in the liquid content of the gas through extraction of the heavier hydrocarbon content does improve the operating efficiency of Panhandle's pipeline system," (R. 544) it also held that the evidence would not support a finding that the extraction process was "an essential part of the business of transporting and marketing the natural gas." (R. 545-546)

The only justification which the Commission gave for departing from its traditional treatment of by-product gasoline operations was that the rates which it prescribed

for the sale of natural gas "should not rest in part upon the fluctuating and unregulated prices of natural gasoline and other liquid hydrocarbons." (R. 545)

After reciting the inconsistencies in the Commission's decision the Court of Appeals pointed out that the facts recited by the Commission concerning these operations clearly brought such operations "within the jurisdiction of the Commission" (App. Pan. 19a; App. F. P. C. 47). The Court further held that the reason given by the Commission for the different treatment in this case, that is, the effect upon rates of fluctuating gasoline prices, did not justify the conclusion that the extracting business should be treated as non-jurisdictional (App. Pan. 19a, 20a; App. F.P.C. 47, 48).

In other words, the court held that the conclusion of the Commission did not follow from the facts and findings recited in its Opinion.

## Argument

### I. THE CASE DOES NOT MERIT REVIEW BY THIS COURT

#### A. *The Decision of the Court of Appeals Is Not Dispositive of the Issue of the Commission's Use of the "Commodity Value" Method.*

That this Court only reviews final decisions is a well settled principle of the law.

In the case of *Laclede Gas Light Co.* v. *Public Service Commission*, 304 U. S. 399, the Supreme Court of Missouri had remanded an order of the Public Service Commission to the Circuit Court

> "* * * with directions to the circuit court to remand to the commission that it may rehear and determine the facts on the four points above mentioned in accordance with the views in this opinion." 341 Mo. 920, 110 S.W. (2d) 749, 780.

The Public Service Commission of Missouri moved to dismiss the appeal to the Supreme Court of the United States on the grounds that there was no final judgment from which an appeal could be taken. This Court, in a *per curiam* opinion, dismissed the appeal stating:

> "As we are unable to conclude upon the record before us that the state court has finally disposed of the controversy, the motion to dismiss the appeal must be granted."
>
> "Dismissed." (304 U.S. 400) See also *Coe* v. *Armour Fertilizer Works*, 237 U.S. 413; *Haseltine* v. *Central Nat. Bank*, 183 U.S. 130.

The instant case consequently does not merit review at this time. The Court below has at this time only *remanded* the case to the Commission for the purpose of affording the Commission the opportunity to justify the prescription of rates which are patently higher than necessary to meet the "end result" test (*Hope Natural Gas Company*, 320 U.S. 591 at 627)—namely, to provide revenues to service the debt, provide a fair return on the equity, pay all operating expenses, and permit the transfer to surplus of a reasonable amount. The Federal Power Commission concedes this in its Petition for Certiorari when it states at page 8: "If the Court had limited its reversal of the field price formula portion of the Commission's Order to the failure of the Commission to make requisite findings or upon what it says is the absence of evidence to support findings, very little national importance would attach to the decision." But the Commission's Petition then opines that the Court must have intended a broader application of its holding than mere lack of findings or evidence by the Court's reference to the "conventional rate base method" "as a basis of comparison" or at least "as a point of departure" in determining whether the rates prescribed by use of the field price method are

"just and reasonable" (F.P.C. Petition, pages 8-9. However, this reference by the Court in no way changes the fact that the actual basis of the reversal and remand to the Commission was the lack of adequate findings to support the Commission's departure from the rate base method and the allowance of an amount in excess of that required to meet the test of a fair return as laid down by this Court in the *Hope* and in other cases. *It is significant that nowhere in its Petition for Certiorari does the Commission assert that the Court erroneously concluded that there was a lack of adequate findings.*

Furthermore, the Court has made no final determination that the Commission may go beyond allowing the recovery of exploration and development costs "as it did in the instant case" by the adoption of the field price method since, as the Court pointed out, it based its decision "upon a different reason than lack of power in the Commission." (App. Pan. 12a; App. F.P.C. 39) Thus, that question is still open.

Panhandle in its Petition (page 15) asserts that the case is "of transcendent importance" because the "question of a proper method of valuing gas in the field is one of vital importance to all producers who sell in interstate commerce" and who were brought within the jurisdiction of the Federal Power Commission by the decision of this Court in the *Phillips*[5] case. But the Commission itself has stated in a Notice of Proposed Rule Making dated November 17, 1954, in Docket No. R-142 (set forth in full hereto as Appendix A, this brief) that there is a "basic difference between the operations of a producer and those of a pipeline company" (App. A, p. 23) and that it was therefore desirous of securing any information, suggestions or proposals as to the principles and methods to be applied by the Commission in its regulation of the rates to be charged

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[5] *Phillips Petroleum Co.* v. *State of Wisconsin, City of Detroit et al.*, 347 U.S. 672.

by independent producers. After receiving suggestions, comments and advice, the Commission, by Order issued December 1, 1955, terminated the rule making proceeding because the information gained had convinced the Commission that it "should not lay down any rule as to what would be necessary or appropriate for consideration in determining the just and reasonable rates of any independent producer subject to our jurisdiction under the Natural Gas Act" (App. A, p. 26).

The Federal Power Commission here recognized what has been a basic principle of this Court with respect to the decision of causes, namely, that decisions should not be made in the abstract but only in connection with concrete propositions in concrete cases.

The Court of Appeals also stated that the only applicable grounds advanced by the Commission in purported justification of its utilization of a "field price" for the company produced gas were two: "the need for encouraging exploration and development of gas resources" and "—that ownership by pipeline companies of their own production facilities, instead of their complete dependence for gas supply on purchases from other producers, would serve the public interest by ultimately resulting in lower rates." (App. Pan 12a, 13a; App. F.PC. 39, 40) Also a third point "—that consumers remote from production sources would be assured of adequate continuous supply" was mentioned by the Court (App. Pan. 13a; App. F.P.C. 40).

After a discussion of the evidence profferred in support of these contentions and upon which the Commission based its inadequate findings the Court concluded that use of the field price method

> "* * * can be justified only in terms of a demonstrated public interest. * * * the evidence and findings must show that the increase in rates thus

caused is no more than is reasonably necessary for the purposes advanced for any increase. Since there is nothing in these proceedings from which such a conclusion could be drawn, *they are fatally defective*[6] In other words, *we do not substitute 'our opinions for the expert judgment of the administrators to whom Congress entrusted the decision.' Federal Power Commission* v. *Hope Natural Gas Co.*, 320 U.S. at 615." (App. Pan. 14a, 15a; App. F.P.C. 41, 42; emphasis supplied.)

Thus, the Court recognized the contention raised by the City of Detroit that the reasons given by the Commission for its adoption of the field price method were erroneous, unsupported by substantial evidence and wholly lacking in adequate findings.

As a consequence, the Court *remanded* the case to the Commission—

> "* * * to enable the Commission, if it so desires, to seek to supplement the record and findings consistently with the views hereinabove expressed." (App. Pan. 16a; App. F.P.C. 43, 44)

The Commission has been granted the opportunity to justify this "field price" method—if it can. At this juncture of the proceedings the case is not ripe for review by this Court.

B. *The Court Below Recognized That a Standard Is Required for Determination of a "Just and Reasonable" Rate*

A careful review of petitioner's position reveals that they deny the need for any standard for rate determination

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[6] As to the necessity of evidence and findings to enable review consistently with statutory authority, see *Capital Transit Co.* v. *Public Utilities Commission*, 93 U.S. App. D.C. 194, 200-202, 213 F.2d 176, 182-184, *cert. denied*, 348 U.S. 816, and cases cited. (Footnote in original.)

purposes. They maintain that any result may be reached by the Commission so long as the end result is not arbitrary (Pan. p. 17; F.P.C. pp. 11-13). Petitioners also maintain that there is no relationship between the field price method and the rate base method, and one cannot be tested by reference to the other.

The Court below recognized this absence of a standard in the "field price" method in holding that the Commission must use the conventional rate base method as an "anchor" and "point of departure." For, as the Court pointed out—

> "It [the conventional rate base method] has been repeatedly used by the Commission and repeatedly approved by the Courts as a means of arriving at lawful—'just and reasonable'— rates under the Act. Unless it is continued to be used at least as a point of departure, *the whole experience under the Act is discarded and no anchor, as it were, is available by which to hold the terms 'just and reasonable' to some recognizable meaning*" (App. Pan. 15a; App. F.P.C. 43; emphasis supplied).

The Court recognized that the requirement of the Act that rates must be "just and reasonable" meant "just and reasonable" in relationship to appropriate standards. The mere recitation by the Commission that in its opinion a rate is "just and reasonable" does not make it so. It is "just and reasonable" only when the evidential facts and the reasons assigned by the Commission are compatible with recognized rate determination standards.

C. *The Decision of the Court Below Is Not in Conflict with the* Hope *and* Natural Gas Pipeline *Decisions of This Court.*

Petitioners erroneously contend that the Court of Appeals decision is in conflict with the *Hope* and *Natural Gas*

*Pipeline*[7] cases and constitutes the same kind of an invasion of the province of the Commission indulged in by the Court of Appeals for the Fourth Circuit, and which this Court condemned in the *Hope* decision. The Court of Appeals in the *Hope* case held that under decisions of this Court the rate base utilized by the Commission could not be based upon prudent investment unless such prudent investment could be found to represent present fair value. (Pan. pp. 13-19, F.P.C. pp. 9-11.)

Petitioners liken the change of regulatory approach from "fair value" to "prudent investment" in the *Hope* case to the instant case where the Commission seeks to change the method of regulation from the rate base method to the "commodity value" or "field price" method. But the comparison is a *non sequitur*. Under both the "fair value" and the "prudent investment" methods, the rate base standard was employed. The Commission and the Courts treated the reasonableness of the prescribed rates in the *Hope* case and in the prior *Natural Gas Pipeline* case by ascertaining the reasonableness of the profit realized from such rates when related to the rate base found by the Commission and from consideration of the financial needs of the companies. But in the instant case the Commission made no such test. It completely ignored the profits realized by Panhandle from the "commodity value" allowance.

The Court below, after pointing out that the amount allowed Panhandle by the Commission for the intended purposes results in a larger revenue than would be obtainable under the rate base standard, stated (App. Pan. 14a; App. F.P.C. 41):

> "This is not an adequate basis for bringing the resulting rates within the 'just and reasonable' stand-

[7] *Federal Power Commission* v. *Hope Natural Gas Co.*, 320 U.S. 591; *Federal Power Commission* v. *Natural Gas Pipeline Company*, 315 U.S. 575.

ard of the Act. The mere fact that the field price method is used does not vindicate the rates."

The issue before the Court below was not that of ascertaining whether the Commission tested the reasonableness of the allowance by a particular standard and whether the standard used was appropriate, but the absolute failure of the Commission to test the reasonableness of the allowance by any recognized standard.

D. *The End Result Test Was Correctly Applied by the Court Below.*

Petitioners apparently misconstrue the "end result" test, which this Court enunciated in the *Hope* decision, *supra*, and maintain that the Court below committed error by failing to recognize such test.

Contrary to this contention, the Court of Appeals considered the test and applied it to the facts of the case (App. Pan. 15a, 16a; App. F.P.C. 43). It concluded that the Commission's decision had met the test from the *company's point of view* since the rates allowed by the Commission provided annual revenues of $3,571,448 in excess of the revenues required to meet the operating costs as well as capital costs of the business, the latter including service on the debt and dividends on the stock.[8]

What petitioners fail to recognize is that a rate to be "just and reasonable" must not only provide enough reve-

[8] The end result" test of the *Hope* case only concerns itself with due process to the company. In the same opinion Mr. Justice Douglas said that "if we are now to tell the Commission to fix the rates so as to discourage particular uses, we would indeed be injecting into a rate case a 'novel' doctrine which has no express statutory sanction." He further pointed out that this "statutory sanction" must be limited to regulation "along recognized and more or less standardized lines" and that "§ 4(a) and § 5(a) contain only the conventional standards of rate making for natural gas companies". *Hope Natural Gas Company* v. *F.P.C.*, 320 U.S. 616.

nue to comply with the "end result" test from the investor or company point of view; but from the *consumer's point of view*, it must *not* provide more revenue than is required by the needs of the utility. As this Court held in its *Hope* decision, *supra*, (p. 603)—

> "The rate-making process under the act, i.e. the fixing of 'just and reasonable' rates, involves a balancing of the investor and the consumer interest."

Contrary to petitioners' contention, the Court below has not been inconsistent. It has held that if the Commission's use of the "commodity value" method allows Panhandle to collect several million dollars a year in rates above and beyond the revenues which the company would secure under the rate of return found by the Commission to be fair, such allowance must be justified by adequate findings based upon substantial evidence.

The Commission sought to justify the extra allowance by reference to objectives which, it said, were in the public interest but without any determination that these objectives, even if legitimate, permitted rates to be fixed at levels providing more than a fair rate of return. Even if encouragement of production is a legitimate reason for providing more than a fair return, which we deny, the allowance must be keyed to the need of the company whose rates are under review. The allowance may not be based upon needs of industry in general (*Summerfield* v. *Civil Aeronautics Board*, 207 F. 2d 205-206, affd. 347 U.S. 67).

The Court has given the Commission an opportunity to justify the need for the extra allowance above that afforded by a fair return under the traditional rate base method and to demonstrate that such allowance is no more than is needed for the intended purposes. This Court should not pass upon the merits of the case until the Court below has reviewed the Commission's further decision in the matter.

E. *The Court Has Raised No Issue* Sua Sponte

Both petitioners (Pan. p. 20, f.n. 15; F.P.C. p. 21, *et seq.*) assert that the Court of Appeals based its decision upon an objection which it considered *sua sponte*, citing *Federal Power Commission* v. *Colorado Interstate Gas Company*, 347 U.S. 492, 498-499. Nothing could be further from the truth. In *Colorado, supra*, the Court of Appeals questioned the lawfulness of the treatment in a rate proceeding of losses resulting from the extraction operations of a company. This treatment had been required by a prior Commission Order authorizing a merger and where the company had not objected to the Commission's exclusion of such loss at any stage of the rate proceeding, but merely to the determined amount of such loss. The case is not in point, for the City of Detroit in its petition for rehearing to the Commission maintained: that the Commission erred in allowing Panhandle the weighted average field price for its produced gas, which bore no relation to Panhandle's costs; that the abandonment of the rate base method was contrary to the Natural Gas Act and the intent of Congress; that no standard was fixed for the determination of the field price; that the field prices were not supported by substantial evidence; and that the Commission's action was arbitrary and capricious. (R. 733.)

Thus, the Court of Appeals raised no issue *sua sponte* since the validity of the use of the "commodity value" method by the Commission was raised on rehearing by the City of Detroit. The contentions of petitioners that the Court acted *sua sponte* are entirely without merit.

II. THE COURT CORRECTLY REVERSED THE COMMISSION'S ORDER TREATING AS NONJURISDICTIONAL THE NET REVENUES RECEIVED BY PANHANDLE FROM ITS EXTRACTION OF LIQUID HYDROCARBONS

Contrary to the contentions of petitioners that in dealing with this issue the Court failed to keep within its proper province and exceeded the bounds of judicial review, the fact is that the Court was well within the periphery of its judicial sphere, which is to decide whether a decision reached by the administrative agency follows from the facts stated as its basis. (See *Saginaw Broadcasting Company* v. *Federal Communications Commission*, 96 F. 2d 544; *certiorari denied*, 305 U.S. 613).

The Court below reviewed the facts set out in the opinion of the Commission concerning Panhandle's extraction operations, the precedents to which the Commission referred and the justification given for departing from established precedent. It held that the Commission's conclusion to treat the by-product extraction operations of Panhandle as nonjurisdictional activity was not supported by the facts recited and the justification given.

The Court found the Commission's position to be inconsistent and conflicting. On the one hand, the Commission found that Panhandle's extraction operations "should be treated as nonjurisdictional" to the extent "it is not requisite to preparation of the gas for pipeline transportation—." (R. 546.) Contrariwise, the Commission stated that its decision to treat the extraction operation as a separate business or department did not rest "upon the question of jurisdiction." (R. 545.) The Commission maintained that with respect to certain facilities used jointly in both the pipeline transportation and extraction activities, it had "unquestioned jurisdiction." (R. 545.)

The Commission, after finding that the reduction in the

liquid content of the gas through the extraction of the heavier hydrocarbons *does* improve the operating efficiency of Panhandle's system (R. 544), sought to distinguish that finding from its similar finding in prior cases, such as the *Hope* case, (3 F.P.C. 100) by quoting from the decision of the Court of Appeals for the Tenth Circuit in the *Cities Service Gas Company* case (155 F. 2d 694, 703; *certiorari denied*, 329 U.S. 773).

The Court below referred to the numerous cases where the Commission had credited the net revenues from extraction operations to the cost of service and cited: *In the Matter of Hope Natural Gas Company*, 3 F.P.C. 150, 178; 134 F. 2d 287, 307-308, reversed on other grounds, 320 U.S. 591; *In the Matter of Cities Service Gas Company*, 3 F.P.C. 459, 480-481, 155 F. 2d 694, 703, *certiorari denied*, 329 U.S. 773; and *City of Columbus* v. *United Fuel Gas Company*, 5 F.P.C. 279, 290. (App. Pan. 17a; App. F.P.C. 45.) The Court concluded that the Commission's interpretation of these prior cases was questionable and pointed out (f.n. 15 to Opinion, App. Pan. 18a, F.P.C. 46) that the Commission in its Opinion in the *Cities Service* case *supra*, had found that the extraction "operation is profitable and renders the natural gas more readily marketable and transportable."

Upon review of the facts recited by the Commission, the Court held:

> "These facts [the evidence produced] regarding the usefulness of the extraction process to the transmission operations, the joint use of facilities, and the joint incurring of expenses, coupled with the obvious fact that the extraction process is incident to the over-all pipeline transmission and resale operations, clearly bring the extraction operations within the jurisdic-

> tion of the Commission." (App. Pan. 19a; App. F.P.C. 47.)

With respect to the effect of the fluctuating prices of gasoline upon resale rates which the Commission cited as a barrier to crediting the net revenues from extraction operations to the cost of service, the Court held:

> "Most of the costs which must be recovered through the rate, such as labor and equipment expenses, are subject to frequent changes, but the Commission has been able to adjust rates satisfactorily. Moreover, it may be noted that *were the field price used as the Commission proposes*, it would undoubtedly vary from time-to-time. The similar problem of fluctuation in gasoline prices would not seem to impose a sufficiently heavy additional burden upon the Commission to justify depriving the consumer of a substantial credit, approximating $2,000,000 in this case, upon the costs to be recouped through rates." (App. Pan. 19a; App. F.P.C. 47-48, Emphasis supplied)

Thus, the Court concluded that the facts and reasons given by the Commission failed to support the conclusion that the extraction operations should be treated as non-jurisdictional nor did they justify increasing the company's interstate rates by more than one million dollars per year. The Court in its review and reversal of the erroneous findings of the Commission did not depart from any well-settled principles of appellate procedure.

Consequently, no review of this issue by the Court is merited.

## Conclusion

For the foregoing reasons it is respectfully submitted that the petitions for writ of certiorari should be denied.

Respectfully submitted,

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JUNE 20, 1956.

# APPENDIX

## APPENDIX A

UNITED STATES OF AMERICA
FEDERAL POWER COMMISSION

Docket No. R-142

Consideration of principles and Methods to be Applied in the Fixing of Rates to be Charged by Independent Producers for Natural Gas Sold in Interstate Commerce for Resale.

(18 CFR, Part 154)

NOTICE OF PROPOSED RULE MAKING

November 17, 1954

1. Notice is hereby given that the Federal Power Commission has under consideration principles and methods to be applied in the fixing of rates to be charged by independent producers of natural gas sold in interstate commerce for resale, or transported in interstate commerce.

2. Necessary to a determination of the rates permitted by the Natural Gas Act to be made, demanded or received by a natural-gas company is the choice of methods to be used in determining the just and reasonable rate for any particular sale. The Commission, recognizing the basic differences between the operations of a producer and those of a pipe-line company, is desirous of securing any information, suggestions or proposals bearing upon the possible effect the several approaches might have upon the public interests towards which the Natural Gas Act is directed.

3. The Commission, therefore, is inviting the submission of suggestions as to the principles and methods to be applied by it in its regulation of the rates to be charged by independent producers for the transportation or sale of natural gas subject to the jurisdiction of the Commission.

It does not desire and will not consider in this connection any further argument on matters of jurisdiction, since for this purpose it assumes that the question of jurisdiction is not involved. The Commission requests that there be no reargument of the legal questions decided by the United States Supreme Court on June 7, 1954 in *Phillips Petroleum Company* v. *Wisconsin et al.*, 347 U. S. 672.

4. This is a matter of national importance and the Commission invites members of the industry, producers, gatherers, interstate pipe-line companies, distributors, consumers, groups and associations representative thereof, State commissions, municipalities, and any other interested persons to submit information, data, views, comments or suggestions in writing concerning the problem. Submittals should be addressed to the Secretary, Federal Power Commission, Washington 25, D. C., for receipt not later than December 13, 1954. An original and nine copies of submittals should be filed.

5. Oral argument on these matters will be held before the Commission on December 15, 1954, at 10:00 a. m. (EST), in the Commission's Hearing Room, 441 G Street, N. W., Washington, D. C. Any person desiring to participate in the oral argument shall notify the Secretary of the Commission on or before December 3, 1954 of such intention and of the amount of time desired for presentation of argument.

LEON M. FUQUAY,
*Secretary.*

(SEAL)

# UNITED STATES OF AMERICA
# FEDERAL POWER COMMISSION

Before Commissioners: Jerome K. Kuykendall, Chairman; Claude L. Draper, Seaborn L. Digby, Frederick Stueck and William R. Connole

Docket No. R-142

In the Matter of Consideration of Principles and Methods to be Applied in the Fixing of Rates to be Charged by Independent Producers for Natural Gas Sold in Interstate Commerce for Resale

## Order Terminating Proceeding

The Commission has under consideration in this proceeding principles and methods to be applied in the fixing of just and reasonable rates to be charged by independent producers of natural gas sold in interstate commerce for resale, or transportation in interstate commerce.

General public notice of the proposed rule-making in the above-entitled matter was given by publication of notice dated November 17, 1954 in the Federal Register (19 F.R. 7696) and by mailing of notice to natural-gas pipeline companies, State regulatory commissions, independent producers, Federal agencies and others who it was considered would have an interest in the matter. In such notices the Commission invited suggestions as to the principles and methods to be applied by it in its regulation of the rates to be charged by independent producers who are natural-gas companies under the Act for their transportation or sale of natural gas subject to the jurisdiction of the Commission.

In response to such notice, as supplemented by a further notice dated December 2, 1954 (19 F.R. 8107) of an extension of time for submittals and oral argument, several dozen written suggestions, comments, and briefs were filed

by interested parties including producers, pipeline companies, distribution companies, State commissions, industry organizations, land and royalty owners' associations and others, respecting the matters involved in this docket. In addition, we heard oral argument on January 11, 12, and 13, 1955, by many of those who had submitted briefs and by the Commission Staff.

However, the information gained in this proceeding convinces us that, on the basis of the record herein, we should not lay down any rules as to what would be necessary or appropriate for consideration in determining the just and reasonable rates of any independent producer subject to our jurisdiction under the Natural Gas Act.

Accordingly, after full consideration of the suggestions, comments, and recommendations submitted, it appears to the Commission that adoption of any standards, principles, or methods respecting the matters and issues involved herein is not appropriate or necessary in carrying out the provisions of the Natural Gas Act. We so find.

The Commission further *finds:*

On the basis of the record herein, the proceeding in this docket should be terminated.

The Commission *orders:*

The proceeding in this docket respecting consideration of principles and methods to be established as a basis for determining just and reasonable rates which may be charged by independent producers for natural gas sold in interstate commerce for resale is terminated.

By the Commission.

LEON M. FUQUAY,
*Secretary.*

Adopted: November 30, 1955.
Issued: December 1, 1955.

FILED
AUG 2 0 1956
JOHN T. FEY, Clerk

IN THE

# Supreme Court of the United States

OCTOBER TERM, 1956

No. 98

PANHANDLE EASTERN PIPE LINE COMPANY, *Petitioner*

v.

CITY OF DETROIT, MICHIGAN, and
COUNTY OF WAYNE, MICHIGAN, *Respondents*

**On Petition for a Writ of Certiorari to the United States Court of Appeals for the District of Columbia Circuit**

## REPLY BRIEF FOR PETITIONER PANHANDLE EASTERN PIPE LINE COMPANY

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## TABLE OF CONTENTS


| | Page |
|---|---|
| I. Introduction | 1 |
| II. Respondents' Inconsistent Positions | 2 |
| III. Commodity Value | 4 |
| A. County of Wayne | 4 |
| B. City of Detroit | 6 |
| IV. Gasoline Extraction Questions | 13 |
| V. Conclusion | 17 |


## TABLE OF CITATIONS


*American Telephone & Telegraph Co.* v. *United States*, 299 U.S. 232, 236 ..... 14
*Banton* v. *Belt Line R. Corp.*, 268 U.S. 413, 422-3 ..... 10
*Colorado Interstate Gas Co.* v. *Federal Power Commission*, 142 F. 2d 943, 954, affirmed, 324 U.S. 581 ... 4
*Columbus Gas and Fuel Co.* v. *Public Utilities Commission of Ohio*, 292 U.S. 398, 414 ..... 10
*Federal Communications Commission* v. *Pottsville Broadcasting Co.*, 309 U.S. 134 ..... 7
*Federal Power Commission* v. *Hope Natural Gas Company*, 320 U.S. 591, 600, 602, 611, 617-18, 638 ...2, 4, 5, 10, 11, 13, 14
*Federal Power Commission* v. *Natural Gas Pipeline Co.*, 315 U.S. 575, 583, 585-6 .....4, 5, 10, 11
*Laclede Gas Light Co.* v. *Public Service Commission of Missouri*, 304 U.S. 398 ..... 6
*Land* v. *Dollar*, 330 U.S. 731, 734, N. 2 ..... 7
*Larson* v. *Domestic & Foreign Commerce Corp.*, 337 U.S. 682, 685, N. 3 ..... 7
*Montana-Dakota Utilities Co.* v. *Northwestern Public Serv. Co.*, 341 U.S. 246, 251 ..... 5
*National Labor Relations Board* v. *Waterman S.S. Corp.*, 309 U.S. 206, 208-9 ..... 6
*Shields* v. *Utah Idaho Central R. Co.*, 305 U.S. 177, 185 11
*United States* v. *General Motors Corp.*, 323 U.S. 373, 377 7


## STATUTES INVOLVED


Federal Power Act ..... 5
Natural Gas Act .....4, 5, 9, 12, 14, 17

Section 4(a), 15 U.S.C. § 717c(a) ..... 4
Section 5(a), 15 U.S.C. § 717d(a) ..... 4

28 U.S.C. § 1257 ..... 6

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**On Petition for a Writ of Certiorari to the United States Court of Appeals for the District of Columbia Circuit**

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## REPLY BRIEF FOR PETITIONER PANHANDLE EASTERN PIPE LINE COMPANY

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### I. INTRODUCTION

It would be inappropriate at this time to answer in detail all the statements of fact and arguments made by each of the respondents. To do so would require complete briefing of the case and might serve in the end only to confuse the issues. This reply is, therefore, limited to answering the basic contentions of the respondents.

## II. RESPONDENTS' INCONSISTENT POSITIONS

Our reply is complicated somewhat by the divergent approaches of the two respondents. The basic discord between the respondents as to the reasons advanced for denying certiorari cannot have escaped the Court's attention. Indeed, in many respects the two briefs in opposition refute one another and are otherwise incompatible. For example:

(1) The City of Detroit disputes the importance of this case (Br. 10-11). Of course, the fact that the Commission has declined, for the time being, to lay down general rules respecting the fixing of rates for independent producers does not detract from the importance of this case. Unquestionably, the matter is of vast significance to the interstate pipelines as well as to the Commission. Moreover, the unsettled status of this litigation would naturally impede the immediate application of the commodity value method to the fixing of independent producer rates.

The County of Wayne takes no such position. Instead, it candidly concedes that "The instant case is of great importance to *all* concerned with the regulation of the natural gas industry engaged in interstate commerce" (Br. 14) (emphasis supplied). It "* * * agrees with Panhandle that this case is the most important rate decision since * * * *Federal Power Commission* v. *Hope Natural Gas Company* * * * " (Br. 13).[1]

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[1] While the County says that its agreement on this point is for "a different reason," it would be more accurate to say for "an additional reason." It is conceded that the case is also important to consumers, particularly since one of the reasons for the Commission's use of commodity value was the dependency of consumers on an adequate supply of gas and the necessity of encouraging further exploration and development by a realistic approach to rate-making.

(2) Consistent with these statements, the County of Wayne does not appear seriously to urge denial of a writ of certiorari. Rather, it argues the merits of the case throughout its brief, principally attacking the Commission's decision. Thus, it asks that this Court "* * * affirm the judgment of the United States Court of Appeals for the District of Columbia Circuit" (Br. 48). This approach necessarily implies that the decision of the Court of Appeals actually and effectively checked the Commission's attempt to depart from the traditional rate base method in the case of pipeline-produced gas. Thus, although the Court of Appeals rejected the contention that the Commission, in order to adhere to the standards of "just and reasonable," could prescribe only the "lowest reasonable rate" (App. 9a), the County of Wayne seeks "affirmance" of the Court of Appeals by making the very same contention again as if in support of the Court's decision (Br. 15, 23, 35).[2]

Conversely, the City of Detroit takes the position that this case is not yet ripe for decision because the Court of Appeals did not finally dispose of the Commission's use of the commodity value method (Br. 8-12, 16). While this position appears to be neutralized by that taken by the County of Wayne, we shall advert again to this argument.

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[2] The County also disputes the evidentiary basis establishing the commodity value of natural gas (Br. 38 *et seq.*) although the Court of Appeals specifically upheld the Commission's determination in this respect (App. 6a). Obviously, the County would not seek affirmance of the Court's decision in such circumstances unless it were clear that the Court's decision was in effect dispositive of the Commission's power to use commodity value in this case.

## III. COMMODITY VALUE

### A. County of Wayne

It hardly seems necessary to reply to this respondent's principal, if not its sole, argument. The argument is that the Commission was wrong when it adopted a commodity value for pipeline-produced gas for the purpose of fixing rates because, it is insisted, *only* the traditional rate base method of fixing rates may be utilized. The County of Wayne premises its case upon the theory that consumers are entitled to the lowest possible rate short of confiscation and that the rate base method achieves such a result.

Neither the Natural Gas Act nor any authority supports this argument.[3] The Act merely provides, Section 4(a), 15 U.S.C. § 717c(a), that "All rates * * * shall be just and reasonable * * *." While Section 5(a) of the Act, 15 U.S.C. § 717d(a), permits the Commission to reduce rates to the lowest level of reasonableness, nothing requires it to do so. This has been the routine construction of the Act. *Federal Power Commission* v. *Natural Gas Pipeline Co.*, 315 U.S. 575, 583, 585-6; *Federal Power Commission* v. *Hope Natural Gas Co.*, 320 U.S. 591, 600, 611; *Colorado Interstate Gas Co.* v. *Federal Power Commission*, 142 F. 2d 943, 954, affirmed, 324 U.S. 581.

Apart from the practical difficulties of fixing the rates just short of confiscation, mentioned by the Court of Appeals (App. 9a), it is obvious that statutory reasonableness denotes a "zone of reasonableness within which the Commission is free to fix a rate vary-

[3] Of course, the Court of Appeals, as has been noted, squarely rejected the argument now urged upon the Court by the County of Wayne (App. 9a).

ing in amount and higher than a confiscatory rate." *Natural Gas Pipeline* case, *supra*. Thus, in *Montana-Dakota Utilities Co.* v. *Northwestern Pub. Serv. Co.*, 341 U.S. 246, 251, Mr. Justice Jackson described the rate standard of the Federal Power Act (which for practical purposes is identical to that of the Natural Gas Act) as follows:

> "* * * Statutory reasonableness is an abstract quality represented by an area rather than a pinpoint. It allows a substantial spread between what is unreasonable because too low and what is unreasonable because too high. To reduce the abstract concept of reasonableness to concrete expression in dollars and cents is the function of the Commission."

The County of Wayne's reliance upon Mr. Justice Jackson's statement of the purpose of the Natural Gas Act (Br. 16) in the *Hope* case, 320 U.S. at 638, is certainly misplaced. The language quoted doesn't even suggest that in every instance the Commission should fix the rate at the level nearest to confiscation. Room for judgment necessarily exists. Moreover, the rate fixed must be consistent with the maintenance of adequate service to the public. In this very case, the Commission found, among other things, that if the public were to continue to receive adequate volumes of natural gas, it was necessary and in the public interest that the pipeline companies themselves undertake further exploration and development of gas reserves, attach new gas reserves, and reverse the trend toward complete dependence upon purchased gas. To precipitate such activity by the pipeline companies themselves, the Commission found it necessary to take a realistic view of the problem and to depart

from dependence upon the rate base method as applied to a pipeline's own gas.[4] The Commission, accordingly, determined to allow Panhandle to recover in its cost of service the value of the gas it produced itself. The ultimate rate fixed included this component and was, therefore, designed to secure maintenance of adequate service to the public.

**B. City of Detroit**

This respondent's basic approach to this case is that it is not ripe for review. The case cited (Br. 8), *Laclede Gas Light Co.* v. *Public Service Commission of Missouri*, 304 U.S. 398 (a state court case), is in no way pertinent to petitions which seek review of a judgment of a United States Court of Appeals. While it is expressly provided by 28 U.S.C. § 1257 that this Court has jurisdiction only over *final* judgments from *state* courts, no similar requirement is imposed with regard to cases from Federal courts sought to be reviewed on certiorari. Moreover, this Court consistently reviews cases such as this. As stated in *National Labor Relations Board* v. *Waterman S.S. Corp.*, 309 U.S. 206, 208-9:

> "It is of paramount importance that courts not encroach upon this exclusive power of the Board if effect is to be given the intention of

[4] This is not intended to imply that there were no other reasons for using the commodity value of the pipeline's own gas in the cost of service. The Commission enumerated several other reasons (Pet. 5-7) and concluded that "the uncontradicted evidence introduced by Panhandle in this proceeding represents a reasonable basis for such pricing" and that "the ultimate public interest will be better served by permitting the pipeline to receive" the commodity value for its own gas (R. 541-2).

> Congress to apply an orderly, informed and specialized procedure to the complex, administrative problems arising in the solution of industrial disputes. * * * It is essential that courts regard this division of responsibility which Congress as a matter of policy has embodied in the very statute from which the Court of Appeals derived its jurisdiction to act. And *therefore charges by public agencies constitutionally created—such as the Board—that their duly conferred jurisdiction has been invaded so that their statutory duties cannot be effectively fulfilled, raise questions of high importance. For this reason we granted certiorari*" (emphasis supplied).

See also *Federal Communications Commission* v. *Pottsville Broadcasting Co.*, 309 U.S. 134. Where the decision of a Court of Appeals involves an important issue of law which governs or is fundamental to the further conduct of the case such as is the situation here, the fact that a judgment of the Court of Appeals is purely interlocutory will not impede this Court's review. *United States* v. *General Motors Corp.*, 323 U.S. 373, 377; *Land* v. *Dollar*, 330 U.S. 731, 734, N. 2; *Larson* v. *Domestic & Foreign Commerce Corp.*, 337 U.S. 682, 685, N. 3. No useful purpose would be served by a remand to the Commission in this case, if the Court of Appeals has erroneously invaded the province of the Commission by restricting the Commission's power to perform its statutory functions.

The question presented (Br. 2) by this respondent rests upon an erroneous conclusion as to the effect of the Court of Appeals decision. If in fact all the Court below had done was to reverse the Commission for failing to make adequate statutory or subsidiary findings

supporting the rates prescribed, it might be argued that the case has little industry or regulatory significance. However, the plain fact is that the Court of Appeals went much further—it actually denied to the Commission the power to use the commodity value of pipeline-produced gas in fixing rates, except possibly in a court-prescribed straightjacket.

As a reading of the opinion of the Court of Appeals will readily show, the Commission used the commodity value of pipeline-produced gas as an element of the total cost of service without reference to any other method of pricing such gas. The Court, however, specifically reversed the Commission on this point and required the Commission, if it was to use commodity value, first to use the rate base method "as a basis of comparison" or "as a point of departure" and in addition, to see to it that the "increase" is in fact needed, etc.

The implication that the Court merely remanded the case so that the Commission could supply some more or less routine findings supporting the rates prescribed is thus without substance. Certainly the Court's directions as to how commodity value may be used govern any further proceedings before the Commission. As a matter of fact, the respondent is rather hard put in its brief (Br. 10) to support this assertion, for it must interpolate and explain the "actual basis of the reversal" as the failure of the Commission "to support the * * * departure from the rate base method." Respondent is thus forced to concede that the decision of the Court below precluded use of the commodity value method in the absence of some further action on the part of the Commission, which

action was required by the Court to be related directly to the rate base or cost approach.[5]

Although the Court conceded that it could not deny economic factors a place in the total structure underlying rates (App. 10a), it did not agree that the economic factors adverted to by the Commission permitted the use of the commodity value of pipeline-produced gas as an element of the total rate structure. Instead, the Court negatived the Commission's power to use the commodity value method as one of independent validity and in fact prescribed its own formula for fixing rates including the use of the rate base method as a method of pricing pipeline-produced gas as an "anchor" and an independent requirement that the amount allowed the pipeline for the gas it produces be just precisely enough and no more than is necessary to keep it producing gas. This is certainly beyond the ambit of court review and a clear encroachment on the Commission's power. In short, the range of the Commission's power to utilize the commodity value of pipeline-produced gas as a component of the rate structure was finally settled unless review by this Court is obtained.

The real nub of the City of Detroit's argument, not essentially different from that of the County of Wayne discussed above, is that the Commission was bound to use the rate base method. The net investment rate base approach, applied literally, results of course in the lowest nonconfiscatory rate; but as has been pointed out above, the Natural Gas Act does not prescribe this

[5] The City of Detroit in its brief (e.g., Br. 9-10) indiscriminately refers to the lack of findings supporting the rates prescribed and the use of the commodity value. Whether inadvertent or not, this lack of distinction serves only to obscure the underlying issue.

as the only possible rate. It can be higher; and as this Court said in *Columbus Gas and Fuel Co.* v. *Public Utilities Commission of Ohio*, 292 U.S. 398, 414, cited by the Court in the *Natural Gas Pipeline Company* case, *supra*, "* * * Insofar as a reasonable rate is something other or higher than the one not strictly confiscatory * * * *the difference, if any, is determined with finality by the appointed officers of the state*"[6] (emphasis supplied). The Court's quarrel with the Commission in this case was with the method used, not with the impact of the Commission's order as such; for it pointed out, "* * * *we would not consider the rates so high as to be unlawful*" (App. 15a) (emphasis supplied). Unless the Commission were bound in some way to use the rate base approach, argument based upon the difference between the results reached by its use and the method used here, or upon the failure to justify that difference, is circular and begs the question. The result here was determined with finality by the expert judgment of the Commission, and it was respondents' burden to show that this result was arbitrary, unjust, or unreasonable. *Federal Power Commission* v. *Hope Natural Gas Co.*, 320 U.S. 591, 602; *Federal Power Commission* v.

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[6] See also *Banton* v. *Belt Line R. Corp.*, 268 U.S. 413, 422-3:

> "* * * A commission or other legislative body, in its discretion, may determine to be reasonable and just a rate that is substantially higher than one merely sufficient to justify a judicial finding in a confiscation case that it is high enough to yield a just and reasonable return on the value of the property used to perform the service covered by the rate. The mere fact that a rate is nonconfiscatory does not indicate that it must be deemed to be just and reasonable. It is well known that rates substantially higher than the line between validity and unconstitutionality properly may be deemed to be just and reasonable, and not excessive or extortionate."

*Natural Gas Pipeline Co.*, 315 U.S. 575, 586; *Shields* v. *Utah Idaho Central R. Co.*, 305 U.S. 177, 185. This was clearly not done in the Court below.

As the City of Detroit would have it, the decision of the Court of Appeals is not in conflict with the *Hope* and *Natural Gas Pipeline Company* decisions of this Court (Br. 13), although it points out at the same time that the Court below held in effect that there is some standard other than "just and reasonable" for the determination of rates (Br. 12). That the second statement refutes the first is manifest. It will be noted that the subsidiary standard prescribed by the Court of Appeals and defended by this respondent is not a standard, but a method—the conventional rate base method of fixing rates. However, this Court has said that:

> "* * * the Commission was not bound to the use of any single formula or combination of formulae in determining rates. * * * *Under the statutory standard of 'just and reasonable' it is the result reached not the method employed which is controlling*" (emphasis supplied).

*Federal Power Commission* v. *Hope Natural Gas Company*, 320 U.S. 591, 602; see also *Federal Power Commission* v. *Natural Gas Pipeline Company*, 315 U.S. 575, 586. In other words, the standard is "just and reasonable"; and if the Commission's meeting of this standard is to be tested, it clearly cannot be done by reference to *one prescribed method or formula for fixing rates.*

The statute fixes "just and reasonable" as the standard by which the Commission is to be guided. The fact that the conventional rate base method has been

sustained as leading to just and reasonable rates does not mean that it must be used to test rates determined by other methods. Such a requirement would replace the Congressional standard with something else. There is no authority for the proposition that the "just and reasonable" standard of the Act must be implemented by one specific method (Br. 12-13) before it can be applied.

What has been said should also dispose of the contention (Br. 15) that the end result test was correctly applied by the Court of Appeals. Obviously, the essential holding by the Court of Appeals that any variation from the rate base method must be tested by that very same method conflicts with applicable decisions of this Court. No matter how respondent explains the Court's decision, the practical result of the decision was to require the Commission to adhere to the rate base method. Any such requirement is obviously at war with the end result test which leaves the Commission free to choose its own method of fixing rates.

It should be added that respondent (Br. 16) predicates its argument that the Court properly applied the end result test upon the assumption that the Commission has, without adequate findings, provided Panhandle "more than a fair rate of return." The Court of Appeals made no such assertion. It is one thing to permit the pipeline to recover an excessive rate of return and quite another to include in the cost of service an amount to compensate it for a commodity it sells. The return is on the investment in the facilities devoted to the public service. The commodity value is for the commodity belonging to the pipeline which it sells. In fact, neither the investment

in gas reserves nor the cost to Panhandle of developing and producing the commodity are included in the rate base upon which a return was allowed by the Commission. In the final analysis, the argument that the end result test was properly applied depends for validity upon the deification of the conventional rate base approach and the assumption that any variation from it requires very extraordinary justification.

## IV. GASOLINE EXTRACTION QUESTIONS

Neither respondent addresses itself to the real questions presented regarding the gasoline issue. There is no answer or challenge by either respondent to petitioner's position with respect to the jurisdictional question decided by the Court of Appeals.

On the issue of the Court's invasion of the Commission's function, the arguments of both respondents again beg the question involved. Contrary to the *facts,* they blandly describe the extraction operation as a "by-product" (Wayne Br. 45, Detroit Br. 18) of the jurisdictional business, although the Commission distinctly found the operation to be unnecessary to the jurisdictional business and therefore a *separate, not* a *by-product,* business. So long as the Commission sees to it that the gasoline business bears its fair share of the joint costs incurred, and no one argues that this was not done, it should be free to depart from a prior practice predicated on facts alien to those found to exist in this case.

The Court in this case undertook to direct the Commission in the discharge of its function and substituted its own notion on the treatment of gasoline revenues for that of the Commission. This was far beyond the review power conferred upon the Court. *Federal*

*Power Commission* v. *Hope Natural Gas Co.*, 320 U.S. at 617-18; *American Telephone & Telegraph Co.* v. *United States*, 299 U.S. 232, 236.

The County of Wayne erroneously states (Br. 47) that the Commission made no allowance for the profits derived from the gasoline operations. The Commission actually leaned over backwards in favor of the jurisdictional customers when it credited or reduced the jurisdictional cost of service (thereby reducing the costs to the rate payers) by an amount reflecting the reduction in the heating value resulting from the extraction (R. 546-47), for it had already reduced the jurisdictional cost of service by excluding therefrom all costs directly associated with the gasoline operation. Nothing in the Natural Gas Act would require the Commission to diminish the cost of service to the rate payers below what it actually cost to serve them.

What has been said applies with equal force to the City of Detroit's argument that the reversal of the Commission on this point by the Court of Appeals was merely a decision that the result reached by the Commission did not follow from the facts stated as its basis. In the past when gasoline operations were necessary to the jurisdictional business, the Commission charged the rate payers for the costs and credited them with the revenues. In this case, having found that the operations are not necessary to the jurisdictional business, the Commission could find no basis for the continuation of the revenue credit.

There seems to be an assumption by the City of Detroit that unless some unspecified findings are made, the Commission is required to credit the gasoline extraction revenues to the cost of service. No basis is

asserted for any such proposition, and to the extent that any findings were required, they certainly were made when the Commission found that the extraction operations were not necessary to the pipeline operation.

The argument (Detroit Br. 18) that the Commission was inconsistent is purely semantic. There was no inconsistency on the part of the Commission in this regard. The Commission unquestionably has jurisdiction over the facilities used jointly in transporting and selling natural gas in interstate commerce and for extracting gasoline; but it does not follow that the Commission has jurisdiction over all of the businesses carried on by means of such facilities.[7] When the Commission said that it would treat the gasoline *operations* as nonjurisdictional, it was being perfectly consistent with its decision not to rest the disposition of this question upon the question of jurisdiction over the *facilities*. Treating the operations as nonjurisdictional merely meant that the costs of these operations would not be included in the jurisdictional as opposed to the total pipeline cost of service.[8] Once this decision was reached, it would naturally be improper to continue crediting the revenues from the operations to the jurisdictional cost of service.

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[7] As pointed out in our petition (25-6), the Commission also has no jurisdiction over sales direct to industrial consumers (that is, sales not for resale) although it does have jurisdiction over the facilities jointly used for that and the jurisdictional business.

[8] The mechanics of determining the cost of service, from which the rate is derived, involves extracting from the total cost of service those costs attributable to the jurisdictional or resale customers. The Commission fixes rates only for the resale customers, and this is done on the basis of the jurisdictional cost of service which does not include costs incurred in making direct (not for resale) sales, for another example parallel in this respect with gasoline extraction operations.

The Court's insistence upon the continuation of the gasoline credit is judicial legislation of the worst possible sort, for aside from the fact that the Court invaded the province of the Commission, it obviously did so without any real appreciation of the problem the Commission sought to meet. The Commission was certainly entitled to review its prior decisions to see whether the facts of modern-day pipeline operation justified continued adherence to them. Having found that there was no longer justification for crediting gasoline revenues, the Commission was certainly entitled to abandon the practice.

## V. CONCLUSION

The decision of the Court of Appeals, as was demonstrated in the petitions herein, presents questions of wide importance to the administration of the Natural Gas Act. These questions should be decided by this Court for the benefit of those subject to the Natural Gas Act as well as the Commission which is charged with administering the Act. In addition, the decision of the Court of Appeals conflicts with applicable decisions of this Court and should be reviewed.

Accordingly, Panhandle earnestly urges this Court to review this case.

Respectfully submitted,

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JOHN T. FEY, Clerk

IN THE

# Supreme Court of the United States

OCTOBER TERM, 1956

No. 98

PANHANDLE EASTERN PIPE LINE COMPANY, *Petitioner*,

v.

CITY OF DETROIT, MICHIGAN and COUNTY OF WAYNE, MICHIGAN, *Respondents*

## PETITION FOR REHEARING OF ORDER DENYING PETITION FOR WRIT OF CERTIORARI AND APPENDICES

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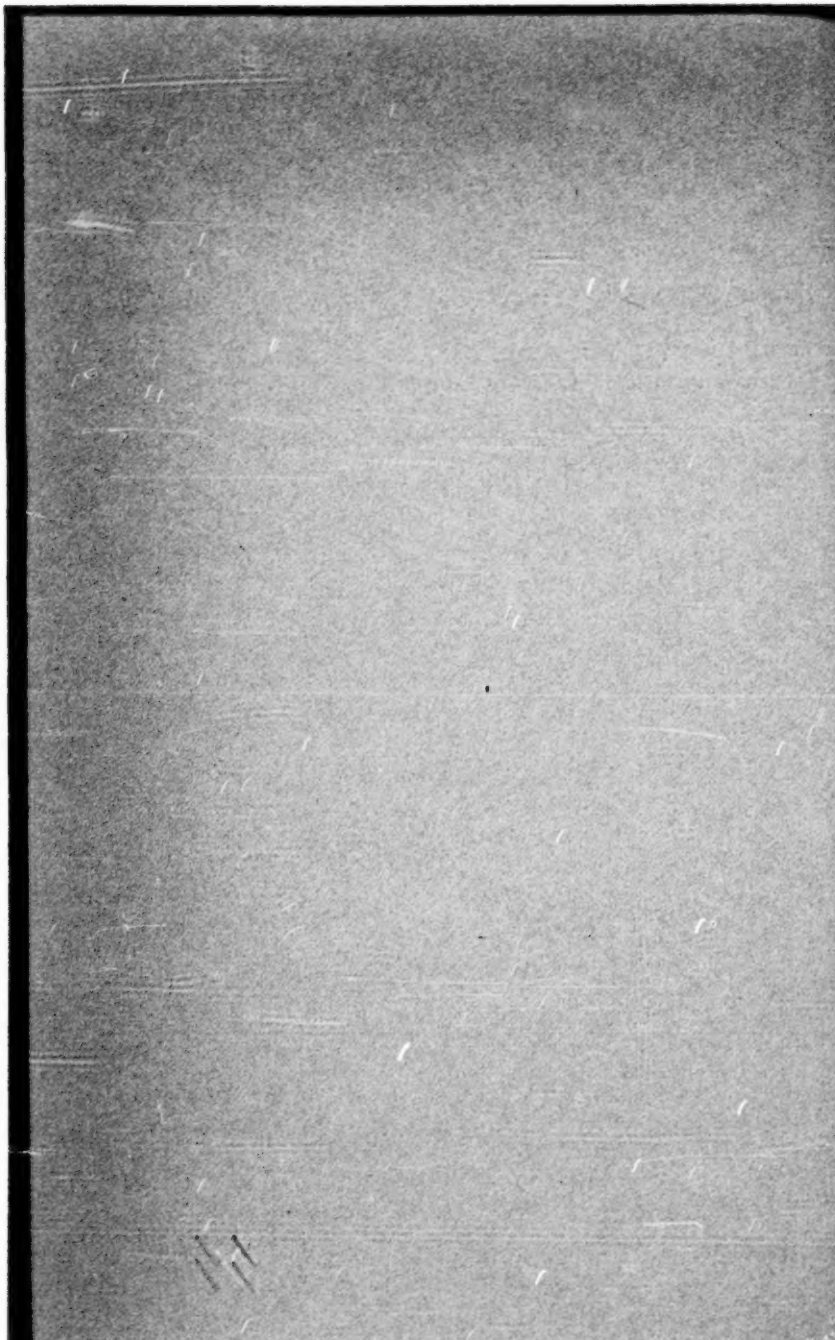

## INDEX


Page

PETITION FOR REHEARING OF ORDER DENYING PETITION FOR WRIT OF CERTIORARI .. 1

REASONS FOR GRANTING A REHEARING AND ISSUING THE WRIT ..... 2

*Introduction* ..... 2
*Recent Developments Evidencing Wide Application of Decision Below* ..... 3
*Immediate Necessity For Determination of Commodity Value Issue* ..... 5
*Decision Below A Mischievous Precedent* ..... 6
*Finality of Decision on Gasoline* ..... 8
*Judicial Amendment of Natural Gas Act* ..... 9
*Impact of Gasoline Decision* ..... 10

CONCLUSION ..... 10

CERTIFICATE OF COUNSEL ..... 12

APPENDIX A

Bibliography of Legal Discussion of Panhandle Case ..... 1a

APPENDIX B

Digest and Summary of Federal Power Commission Cases Involving Commodity Value as the Price for Natural Gas ..... 2a

Summary ..... 12a


## TABLE OF CASES


*Brown* v. *Allen*, 344 U.S. 443 ..... 2
*Colorado Interstate Gas Co.* v. *Federal Power Commission*, 324 U.S. 581, 601 ..... 5
*Federal Power Commission* v. *Panhandle Eastern Pipe Line Company*, 337 U.S. 498, 506-7 ..... 8
*House* v. *Mayo*, 324 U.S. 42 ..... 2
*Panhandle Eastern Pipe Line Company* v. *Federal Power Commission*, 324 U.S. 635, 641-2 ..... 9
*Phillips Petroleum Company* v. *Wisconsin*, 347 U.S. 672 4
*Securities and Exchange Commission* v. *Chenery Corp.*, 332 U.S. 194, 207 ..... 7
*United States* v. *Carver*, 260 U.S. 482 ..... 2

FPC OPINIONS

Page

*In the Matter of El Paso Natural Gas Co.*, Docket No. G-2018, FPC Opinion No. 278, issued November 26, 1954 ..... 4

*In the Matter of Northern Natural Gas Company*, Docket No. G-1618, FPC Opinion No. 230, issued June 18, 1952, folio pp. 7-13 ..... 7

MISCELLANEOUS

Natural Gas Investigation (Docket No. G-580), Report of Commissioners Smith and Wimberly, U.S.G.P.O., 1949 ..... 7

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## PETITION FOR REHEARING OF ORDER DENYING PETITION FOR WRIT OF CERTIORARI AND APPENDICES

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Panhandle Eastern Pipe Line Company prays that this Court grant a rehearing of its order of October 8, 1956, denying the petition for a writ of certiorari filed herein,[1] and further prays that, upon rehearing, a writ of certiorari issue to review the judgment of the United States Court of Appeals for the District of Columbia Circuit in this case as prayed for in the petition.

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[1] A companion petition by the Federal Power Commission, No. 113, October Term, 1956, was similarly denied.

## REASONS FOR GRANTING A REHEARING AND ISSUING THE WRIT

### Introduction

A petition for rehearing is often merely the unnoticed epitaph on the grave of a litigant's cause. We believe it vital to all producers of natural gas that this fate not befall this petition.

It is almost inconceivable that the Court could have failed to appreciate the wide impact of the answer by the Court of Appeals for the District of Columbia Circuit to the underlying questions presented by this case. It is difficult to believe that this Court considers these questions involving, as they do, the fundamental rate regulatory powers and policies of the Federal Power Commission under the Natural Gas Act, of insufficient importance to warrant its attention.[2] Moreover, since this Court has repeatedly said that its denial of a petition for a writ of certiorari should not be taken as indicating its views on the merits of the case,[3] it cannot be assumed that the Court has made its determination on the merits of the case. It would appear, therefore, that the Court must have been under some misapprehension as to the finality of the decision of the Court below. In any event, the responsibility for this situation rests largely upon the petitioner, and in fairness to itself and to the Court, petitioner seeks, with a minimum of repetition, to correct any such possible misconceptions.

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[2] That this is a landmark case can hardly be denied. It has provoked extensive comment. Appendix A contains a bibliography of a few of the articles and comments concerning this case. We *do not necessarily subscribe* to or ask the Court to agree with, the different views advanced. The point is simply the general concern with the underlying questions involved.

[3] *Brown* v. *Allen*, 344 U.S. 443; *House* v. *Mayo*, 324 U.S. 42; *United States* v. *Carver*, 260 U.S. 482.

**Recent Developments Evidencing Wide Application of Decision Below**

Neither Panhandle's own interest, that of the Commission, that of the natural gas industry as a whole, nor the public interest, can be served by postponing this Court's consideration of this case. If the decision of the Court below in this case involved only the interests of Panhandle, there might be some reason to avoid deciding the commodity value question until it becomes clear that the dual rate formula prescribed by the Court below would not result in the same rates as were reached under the commodity value approach. But, it is applicable to scores of cases now pending in the Commission; and, it is being so treated by the Commission and its examiners.

This is, in reality, a test case. It is the first case to reach this Court which squarely raises the question of the Commission's *power* to utilize *commodity value unrelated to a rate base* to fix the price of natural gas. While the Commission's decision in this case does not mean that it may not, in the future, decide to use some other method, the fundamental question from now on is whether the Commission has the power to use any approach other than one predicated upon a rate base.

When the petition was filed in this case it was not feasible to point out in detail the very significant developments taking place at the Commission level as a direct result of the decision of the Court below. These are recent and cogent matters placing this case in sharper perspective. Even so, we deem it inappropriate to dissipate the Court's time here with all the details. Accordingly, because access to these matters is not readily available, petitioner has prepared Appendix B as a digest and analysis of the more significant cases which have reached the decision stage in the Commission. These developments confirm the crying need for review now.

Shortly after the *Phillips*[4] decision, the Commission decided the *El Paso*[5] rate case, another pipeline proceeding, on the basis of the commodity value of El Paso's gas. In that decision the Commission said that whatever method was to be used to fix the price of natural gas should be employed for *both* the independent producer and the pipeline company (App. B, p. 2a). Thus, the commodity value question presented to the Court by the petition herein is a question common to all producers of gas for resale in interstate commerce whether they be pipelines or independent producers. This is borne out by Appendix B which shows that the decision of the Court below in this case has directly affected every subsequent rate proceeding acted upon by the Commission and its trial examiners. Reference to Appendix B will also show that the Commission and its trial examiners have been unable to apply to any of the cases before them, with any degree of consistency or success, the judicially prescribed formulas contained in the decision of the Court below. There seems to be no common understanding of the decision and no recognizable definition of the type and quantum of evidence which will meet the dual standards for rate making now prescribed, viz., the "just and reasonable" standard contained in the Natural Gas Act and the superimposed formula dictated by the Court below.[6]

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[4] *Phillips Petroleum Company* v. *Wisconsin*, 347 U.S. 672.

[5] *In the Matter of El Paso Natural Gas Co.*, Docket No. G-2018, FPC Opinion No. 278, issued November 26, 1954.

[6] The formula imposed by the Court is really a double barrelled dilemma. The Court said the Commission could depart from the rate base method and use commodity value. *However*, to do so the Commission must *first* utilize a rate base as a point of departure and *then* see to it that the difference between the results reached by the two methods is precisely the amount needed to encourage exploration, etc. Apparently only where the results reached under this Janus-faced approach coincide with the commodity value could the Commission then use that value as the price of produced gas rather than some other price. Thus, the Commission's power to use commodity value is left to depend upon pure happenstance.

The short of the matter is, as demonstrated in Appendix B, that the Commission is bound by the decision in this case and feels itself so bound, not only in this but in every one of the many cases involving the price producers may obtain for their gas. And yet, it will be observed, the Commission itself has commented upon the "difficulties inherent in fixing the rates of a natural gas producer by allowance of a rate of return on an original cost rate base" (App. B, p. 7a), and it has repeatedly referred to the "uncertain and nebulous state of the applicable law" (App. B, pp. 5a, 8a, see also App. B, p. 12a).

There are literally hundreds of rate cases pending in the Commission now.[7] And it is clear that irrespective of any lack of finality which might be ascribed to the decision of the Court below in this case, the Commission is trying to apply that decision to every case involving the price of natural gas that comes before it.

**Immediate Necessity for Determination of Commodity Value Issue**

Because of the extremely broad impact of the rate making principles announced by the Court below, it must be assumed that the issue now presented will be the subject of extensive further litigation. However, since the Commission apparently intends to apply to every rate case the court-prescribed dual formula, this is the only case which will afford this Court the opportunity to review a proceeding in which the Commission has actually utilized the commodity value approach in its pristine form. Except for this case, review by this Court can be had only in a situation wherein the Commission has attempted to apply the principles of the decision below and thereby has refused to use commodity value alone. *Cf. Colorado Interstate Gas Co.* v. *Federal Power Commission*, 324 U.S. 581, 601.

[7] In September, 1956, alone, about one hundred rate filings were made. To be sure, not all of these cases involve the fair field price or commodity value for natural gas, but a substantial number do.

Thus, while subsequent review is almost inevitable, the underlying issue will never be so cleanly presented as now.

Further proceedings in this case by the Commission can develop no additional facts that would assist this Court in deciding whether the Commission is entitled to use commodity value in pricing natural gas without reference to the results of a different approach. All essential facts have already been developed in extensive hearings in this case. Moreover, as pointed out above, this is actually the only case which will ever come before the Court in which the Commission has applied a straight commodity value approach to fixing the price for gas at the wellhead.

Delay of the Court in deciding this case can result only in adverse effects on the natural gas industry and the public. In the meantime the entire industry and the Commission will still not know whether natural gas can be priced as a commodity without necessary reference to a rate base. This situation, bordering on chaos, and the multitudinous litigation that will inevitably result, can only be avoided by a definitive decision by this Court *now*.

**Decision Below a Mischievous Precedent**

The fundamental question regarding the Commission's power to use a commodity value for natural gas is whether the reasonableness of a rate can be established only by the rate base method. Concededly, a rate base constitutes a necessary method for determining judicially whether a rate prescribed by a regulatory body is *confiscatory in a constitutional sense*. This was the reason for development of this method by the courts and the only purpose to our knowledge for which it has ever been used. There is no decided case (other than this one) of which we are aware, where no question of confiscation was involved, which holds that the rate base method *must be used* in fixing rates. The decision of the Court below *requires the use of a rate base for all rate making under the Natural Gas Act;* and this, we respectfully suggest, is plain judicial legislation, for the Natural Gas Act contains no such requirement.

By so pointedly substituting its wisdom for that of the Commission, the Court below has created a mischievous precedent in the whole field of administrative law. As this Court has said, in *Securities and Exchange Commission* v. *Chenery Corp.*, 332 U.S. 194, 207:

> "The scope of review of an administrative order wherein a new principle is announced and applied is no different from that which pertains to ordinary administrative action. The wisdom of the principle adopted is none of our concern. * * *"

In this case the Commission, the chosen arm of Congress, the expert body charged with protecting the public interest, determined that its use of the rate base method in fixing the price of natural gas had destroyed the pipelines' incentive to develop their properties and increase the quantity of gas available and, therefore, that it had done the industry and the public grave harm (R. 541). It decided that a departure from the rate base method and the use of a conservative commodity value was not only proper but urgently required (R. 541-2).

This was not a frivolous or hasty decision. Rather, it was a decision born of long study, careful observation, and the first appropriate record (R. 522). The matter had been under study since 1948 and the trends and facts relied upon by the Commission in this case (R. 540 *et seq.*) had been observed and commented on prior to the decision of this case.[8] In fact, the problem[9] was alluded to by this Court

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[8] See "Natural Gas Investigation (Docket No. G-580)," Report of Commissioners Smith and Wimberly, U.S.G.P.O., 1949. See also *In the Matter of Northern Natural Gas Company*, Docket No. G-1618, FPC Opinion No. 230, issued June 18, 1952, folio pp. 7-13, concurring opinion of Commissioner Smith, showing that the volume of natural gas produced by pipelines declined from almost 50% of sales in 1940 to 18.5% in 1951.

[9] Independent producers have been motivated by the incentive of obtaining a commodity value for their gas while the pipelines have not; and the independent producers might still have that incentive were it not for the decision in this case. Application of the rate base method to independent producers will surely destroy their incentive just as it did for the pipelines.

in *Federal Power Commission* v. *Panhandle Eastern Pipe Line Company,* 337 U.S. 498, 506-7, when it observed that:

> "* * * it was apparent that the value of producing facilities and the cost of gas bought by a natural-gas company from producers would be weighty factors in rate making *whether a rate-base method or other method for fixing rates was used. Low valuation by the Commission of producing properties or low-cost allowance for purchased gas discourages exploration for gas for its sale in interstate commerce.*" (emphasis supplied)

**Finality of Decision on Gasoline**

For the most part the arguments already advanced apply with equal or greater force to the gasoline question. Moreover, there appears to be little or nothing left to be done on the gasoline issue except to remake the rates so as to credit the jurisdictional cost of service with the gasoline revenues. Both the jurisdictional issue and the question as to the Commission's power to make a proper cost allocation as between gasoline and natural gas are obviously ripe for decision by this Court. These questions have never been presented to this Court before and should, we submit, be decided without further delay. The Court of Appeals categorically held the extraction operations to be "within the jurisdiction of the Commission" (App. 19a), and that the Commission was required to credit the revenues therefrom to the jurisdictional cost of service notwithstanding the Commission's finding that the extraction operations were not necessary to the transportation of natural gas, but instead a separate, profitable business of Panhandle. Under the Court's opinion (App. 20a), apparently the only avenue left open is to threaten abandonment of the profitable extraction operations rather than permit the gas consumer to obtain the free ride afforded by the decision of the Court of Appeals. Certainly no benefit can inure to the public from any such approach.

**Judicial Amendment of Natural Gas Act**

The basic problem here is simply one of allocating the expenses and revenues attributable to the extraction and sale of gasoline removed from natural gas. All that is legally required is that natural gas, the only subject of rate regulation under the Act, bear its share of such joint costs, which in turn means that gasoline must also bear its fair share of the joint costs. *Panhandle Eastern Pipe Line Company* v. *Federal Power Commission*, 324 U.S. 635, 641-2.

No formula for determining how these expenses and revenues should be allocated was provided in the Natural Gas Act. The Act does not cover the sale of gasoline or require the Commission to credit the gasoline revenues. The Court below *did not* hold that the cost allocation formula utilized by the Commission failed to require the gasoline extraction to bear its fair share of the joint expenses. Nor did it point to any provision of the statute which compelled the Commission to credit to the jurisdictional cost of service these revenues from *a business which is independent of the transportation and sale of natural gas for resale.* Without any warrant, statutory or otherwise, the opinion of the Court below denies the Commission all discretion in the matter and confers upon the gas consumers the legal right to pay the gasoline extraction expenses and to receive the gasoline profits. In short, by the mere judicial fiat of the Court of Appeals, Panhandle's customers have been irrevocably established in the business of extracting and selling gasoline and the stockholders of Panhandle have been put out of that private enterprise. There is absolutely no relationship between the right of the consumers of natural gas to "just and reasonable rates" and the holding of the Court below. This is an extreme instance of judicial rate making which this Court would be warranted in vacating summarily.

**Impact of Gasoline Decision**

The lower Court's square holding that gasoline extraction operations are not only subject to the jurisdiction of the Commission but inseparable from the natural gas business, raises a very serious problem to every producer of natural gas. It is common knowledge that oil and natural gas frequently come from the same well and that gasoline is extracted from both products. If, in such situation, gasoline revenues must be credited to the cost of service for natural gas, then logically why not also the revenues from oil? It is also common knowledge that a large share of the income of many so-called independent producers is derived from the sale of gasoline or oil produced in conjunction with natural gas. Among the perplexing problems now confronting the Commission is the question of a proper allocation of expenses between these several products of joint operations. If the decision in this case is to be strictly followed, there is no logical reason to attempt an allocation of such joint expenses. By hypothesis, all expenses and revenues would simply be a part of the make-up of the price of natural gas. The issue underlying these questions is, we submit, far too important to be deferred.

## CONCLUSION

The ultimate disposition of the questions posed by this case depends, in the final analysis, on the answers to two questions:

1. Is there anything in the Natural Gas Act which *precludes* the Federal Power Commission from using the commodity value method of pricing a natural gas company's own production *unless* it is related to the comparative results reached under the rate base method?

2. Is there anything in the Natural Gas Act which says directly or otherwise that the extraction of gasoline is an *inseparable* part of the transportation or sale of natural gas in interstate commerce, or that the Fed-

eral Power Commission is *required* to lump the gasoline business into the natural gas business for rate making purposes?

If this Court is completely satisfied that both of these questions must ultimately be answered in the affirmative, then, except for the clarification that is now needed, review might well be deferred.

If, however, the Court is not so satisfied, then in fairness to all, the Court should, we believe, accept this case now.

Respectfully submitted,

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We hereby certify that the foregoing Petition for Rehearing is presented in good faith and not for delay and is restricted to grounds specified in Rule 58 of the Rules of this Court.

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# APPENDIX

## APPENDIX A

### Bibliography of Legal Discussion of Panhandle Case

ARTICLES

Abrams, "What Happens Now to FPC Gas Regulation?" 57 Public Utilities Fortnightly 361, 363-364 (1956).

Falck, "What Do the Panhandle and Phillips Cases Mean?" 53 Public Utilities Fortnightly 639 (1954).

Francis, "Rate Regulation of Natural Gas Companies," Law and Contem. Prob., Sum. '54, 413 (1954).

Jones, "Compensating Producers for Gas Reserves," 58 Public Utilities Fortnightly 366 (1956).

McLane, "Jurisdiction of the Federal Power Commission Over Production and Gathering of Gas," 28 Tulane L. Rev. 343, 358-359 (1954).

Welch, "Is FPC Gas Producer Regulation Here To Stay?" 57 Public Utilities Fortnightly 505, 507-508 (1956).

COMMENTS

Kaye, "Extension of Federal Regulation of Natural Gas Production," 40 Cornell L. Q. 328, 339 (1954-55).

Kaye, "Are 'Conventional Methods' Necessary in Natural Gas Rate Regulation?" 41 Cornell L. Q. 438 (1955-56).

CASE NOTE

City of Detroit v. F.P.C., 69 Harv. L. Rev. 1517 (1956).

ADDRESSES

The case was referred to in three separate addresses before the Public Utility Law Section of the American Bar Association at Dallas, Texas, August 26-29, 1956. These addresses have been printed in the Public Utilities Fortnightly as noted below.

Gatchell, "FPC Problems in Gas Regulation," 58 Public Utilities Fortnightly 509, 515 (1956).

Illig, "Rate Regulation Problems Affecting the Independent Gas Producer," 58 Public Utilities Fortnightly 502, 503 (1956).

Russell, "Rate Regulation Problems Facing the Gas Distributor," 58 Public Utilities Fortnightly 519, 525 (1956).

## APPENDIX B

### Digest and Summary of Federal Power Commission Cases Involving Commodity Value as the Price for Natural Gas

*In the Matter of El Paso Natural Gas Company*, Docket No. G-2018, FPC Opinion No. 278, issued November 26, 1954, was a rate case in which the commodity value of El Paso's gas was allowed. In that decision, the Commission referred (folio p. 6) to its "newly found jurisdiction over independent producers" and said that while it might consider " * * * methods and principles [other than commodity value] in determining the amount to be allowed in the cost of service for gas produced by a pipe-line company or an independent producer * * * such method as may be adopted in the future should be employed for both the independent producer and the pipe-line company."

*In the Matters of Cities Service Gas Company, et al.*, Docket No. G-2569 *et al.* involved the issuance of certificates of public convenience and necessity to an independent natural gas producer. Subsequently the case became known as the *Signal Oil* case. Signal applied for a certificate of public convenience and necessity to sell to Cities Service. The rate at which Signal proposed to sell was 12¢ per Mcf. Intervenors opposed certification of Signal on the ground that commencement of sales at 12¢ per Mcf would trigger "favored nation clauses" in contracts between them and their gas suppliers, and thereby raise the price of natural gas to them. The evidence showed that the prevailing or area price was 10¢ per Mcf. The trial examiner recommended the issuance of a certificate to Signal conditioned upon its filing a rate schedule providing for a 10¢ rather than the proposed 12¢ price.

Upon review by the Commission, Signal contended that its 12¢ rate was reasonable because the result of an arm's length transaction negotiated under free competitive conditions. The Commission upheld the examiner, *In the Matters of Cities Service Gas Company and Signal Oil & Gas Company,* Docket Nos. G-2569 and G-2570, FPC Opinion No. 288, issued November 28, 1955, and stated (folio p. 20) that:

> "* * * Imposition of a condition calculated to maintain an area price at an existing rate is consistent with our decisions in *Panhandle Eastern Pipe Line Company, et al.*, Docket No. G-1116, *et al.*, Opinion 269, issued April 15, 1954, and *El Paso Natural Gas Company,* Docket No. G-2018, Opinion No. 278, issued November 26, 1954. While in these cases an average of the prices in the area involved was used, and in this case the average area price is a fraction less than ten cents, such a precise determination is not required here since we do not purport to determine the just and reasonable rate within the meaning of Section 4."

Thus the commodity value concept was utilized to maintain a lower area price.

Shortly after the decision in the *Signal Oil* case, on December 15, 1955, the decision in the instant case was handed down by the Court of Appeals. The Commission issued an Order denying rehearing in the *Signal Oil* case on January 13, 1956. This Order reflects the immediate effect that the decision of the Court below had upon the Commission's concept of the proper method of determining the price of gas. It said (folio p. 3):

> "* * * The rate we deem proper to be charged if a certificate should issue is not necessarily the same we could find to be the lowest reasonable rate under Section 5. Criteria for prescribing a rate necessarily differ from criteria for proscribing a rate.
>
> "Proof of arms-length bargaining and evidence of area or field prices do not suffice to sustain the burden of proof under a Section 4 or Section 5 proceeding. We

> recognize that such evidence is relevant to a determination of just and reasonable rates. * * *"

Prior to the decision by the Court of Appeals, therefore, the Commission had already applied a commodity value in two pipeline rate cases and one producer certificate case, the *Panhandle* case, now before this Court, the *El Paso* case, *supra*, and the *Signal Oil* case *supra*. Immediately after the decision the Commission apparently abandoned commodity value as a method of fixing the price of gas, saying only that commodity value would be considered. In every subsequent case the Commission and its trial examiners have made it clear that there had to be evidence upon which a rate base could be established.

On February 3, 1956, the examiner's decision was issued *In the Matter of Davidor & Davidor*, Docket No. G-8550. The evidence adduced in support of a proposed 10¢ per Mcf rate showed that the prevailing or field price of gas in the area was 10¢ per Mcf. Evidence of what the applicant called "Net Cash Realization Required for Applicant to Continue in the Gas Business" was also introduced. This was shown to be the receipt of $3 for each $1 spent. The examiner thought that none of the evidence introduced aided in determining a just and reasonable rate since the evidence did not include all of the applicant's operations.

The Commission reversed the examiner's decision, stating (folio pp. 2-3) that:

> "Applicant put in its case on a 'dollar-in dollar-out' basis, arriving at the 'net cash realization' from the operation of the property by computing the difference between total revenues over the life of the wells and all 'direct costs' necessary to obtain revenue. Although perhaps leaving something to be desired in completeness, applicant's rather empirical presentation is adequate for purposes of this case. * * *
>
> * * * * *
>
> "Evidence also was adduced of current prices for comparable sales of natural gas in the same general

area. Respecting evidence of arm's-length bargaining and of area or field prices, for present purposes our position on this matter is sufficiently stated in our order issued on January 13, 1956, *In the Matters of Cities Service Gas Company and Signal Oil and Gas Company,* Docket No. G-2569, *et al.*, where we said, *inter alia,* that although '[p]roof of arm's length bargaining and evidence of field prices do not suffice to sustain the burden of proof under a Section 4 or Section 5 proceeding,' . . . '[w]e recognize that such evidence is relevant to a determination of just and reasonable rates.' Here again, although the evidence relevant to these matters leaves something to be desired in completeness, it deserves our consideration, and shows that a rate of 10¢ per Mcf is reasonable in comparison with other prices being charged in the area, and is, in fact, the 'going rate'.

* * * * *

"Without deciding what control, if any, the decision of the United States Court of Appeals for the District of Columbia Circuit in *City of Detroit* v. *Federal Power Commission*, decided December 15, 1955, has at this time over the instant case, we observe that the record seems to satisfy the requirement therein stated, that the rate base method must be used as a basis of comparison with rates proposed under another theory or method.

"We cannot say, in view of the uncertain and nebulous state of the applicable law, that proof of the character here submitted would justify a rate increase in all or any other similar cases. However, we are satisfied, as a matter of fact, that a rate of 10¢ per Mcf is just and reasonable in this proceeding."

On February 16, 1956, another examiner issued a decision *In the Matter of Wunderlich Development Company,* Docket No. G-3940. In this case extensive cost evidence was submitted by the applicant in support of its 10¢ rate. By formulas adopted and used by the applicant an allocation of the total cost of its natural gas business was made between the residue gas and the extracted liquid hydrocarbons, and this resulted in a showing that the costs were substantially in excess of the proceeds from the sale of

the residue gas. The evidence also showed the field price of the gas in the area to be 10¢ per Mcf. The examiner recommended approval of the increase.

Although no exceptions were taken to the examiner's decision, the Commission reviewed the decision and affirmed, stating in its Order issued March 19, 1956 *inter alia*:

> "Although counsel for Wunderlich took the position that the reasonableness of a rate for gas was not to be determined upon a cost of service basis but by the reasonable value of the gas as a commodity, nevertheless, did introduce evidence as to cost of service during the hearing. Evidence was also introduced to show the price at which independent producers sold their residue gas to pipeline companies in the State of Oklahoma. * * * Counsel for Wunderlich stated that the evidence concerning prices paid to others for residue gas was presented to show the area price as distinguished from the field price.
>
> "We do not pass on the question of whether evidence of the character now before us would in any other case substantiate a given rate as just and reasonable. We consider it sufficient in this proceeding to point out that the increased price of 10¢ per Mcf, effective on September 1, 1954, is not unlawful but is reasonable under the circumstances disclosed by the record in this proceeding."

On April 25, 1956, an examiner issued a decision *In the Matter of Christie, Mitchell & Mitchell*, Docket No. G-3669. Applicant here had made a full presentation of the field price as justification for its 10¢ price. The applicant also offered cost evidence which, while somewhat more complete than the dollar-in dollar-out presentation in the *Davidor* case, *supra*, was of the same general type. Applicant contended that use of a cost of service did not provide a proper basis for fixing producer rates, and that it was entitled to the 10¢ field price it had shown.

The trial examiner reviewed all of the evidence and decided that it was not necessary to consider whether any

one of the types of evidence received would suffice to resolve the issue of justness and reasonableness and held that the evidence in its entirety supported the proposed increase.

The Commission affirmed, by its Order issued June 29, 1956, stating that:

> "The Presiding Examiner has pointed out that the staff has allocated a portion of the cost of drilling three dry holes to the Rice No. 1 working interests as exploration and development expenses, and these expenses were amortized over a six year period, the estimated life of the well. (Exhibit No. 3.)[1]
>
> "We believe this was a proper and fair thing to do under the circumstances. However, we note in passing that this procedure is not in accord with the treatment usually accorded to pipeline companies. In the case of pipelines, none of the nonproductive well drilling expense would be considered, since none of it occurred in the test period, and the cost per Mcf of the gas would be reduced to approximately 6¢ per Mcf, if the Btu allocation between gas and condensates is used. If the revenues and expenses of the condensates and natural gas operations are considered collectively and the revenue from condensates is deemed to remain at $2.90 per barrel, the cost of gas would be around 4¢ per Mcf, when no consideration is given to nonproductive well drilling costs.
>
> "On the other hand, if all the dry holes had been drilled during the test year (which is not the case), if the Btu allocation were used, and if the condensates operations were treated jointly as mentioned in the preceding paragraph, the cost of the gas would be approximately 40¢ per Mcf.
>
> "A rate of return of 10% has been applied in the foregoing calculations, which is the same rate used by the staff in its presentation. We must agree with the examiner that we have very little

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"[1] Allocation of the cost of service results in a range in costs between 9.70¢ and 11.95¢ per Mcf, depending on the tax rate and on the method of allocation used in the computation. [Footnote is the Commission's.]

in the record on which to base a sound conclusion that 10% is a proper rate of return to be allowed in this case. All this discussion demonstrates some of the difficulties inherent in fixing the rates of a natural gas producer by allowance of a rate of return on an original cost rate base.

"We adhere to what we said in Davidor & Davidor, Docket No. G-8550, that evidence of field prices and arm's length bargaining, alone, does not sustain the burden of proof under a Section 4 or Section 5, proceeding.

"Without deciding what control, if any, the decision of the United States Court of Appeals for the District of Columbia Circuit in *City of Detroit* v. *Federal Power Commission*, decided December 15, 1955, has at this time over the instant case, we observe that the record seems to satisfy the requirement therein stated, that the rate base method must be used as a basis of comparison with rates proposed under another theory or method.

"We cannot say in view of the uncertain and nebulous state of the applicable law, that proof of the character here submitted would justify a rate increase in all or any other similar cases. However, we are satisfied, as a matter of fact, that a rate of 10¢ per Mcf is just and reasonable in this proceeding."

The next decision involving the rates of an independent producer was *In the Matter of Union Oil Company of California, et al.*, Docket No. G-4331, *et al.*, issued May 2, 1956. This case and those subsequently discussed have not been passed upon by the Commission. This is one of the largest producer rate cases and has quite a history. The producers' case in chief was concluded on September 23, 1955. Motions to dismiss were filed at the close of the presentation of the evidence by the producers and on October 24, 1955, the Commission issued an Order postponing action on the motions to dismiss. The proceeding was reconvened on November 28, 1955, and additional evidence was offered, and the motions to dismiss were renewed. Again, the Commission postponed ruling on the

motions to dismiss by an Order issued January 23, 1956. Further hearings were held during March 1956 and the examiner finally issued the decision above referred to granting the motions to dismiss. The case has since been argued and re-argued before the Commission.

The producers' evidence consisted primarily of a showing of arm's length bargaining and other contract prices in the field. In its order of October 24, 1955, the Commission analyzed the evidence presented (and it will be recalled that this was prior to the decision in the instant case by the Court of Appeals), and concluded:

> "But the evidence which they have submitted in support of these contentions [namely, contract prices and the arm's length bargaining] does not convince us that the proposed increased rate is just and reasonable. * * *
>
> "The exhibit submitted by applicant to show relative field prices is merely a numerical listing of contract prices for gas sold within the pricing area and is insufficient to justify the proposed increases."

The examiner found that the evidence offered in subsequent phases of the case was largely cumulative of the evidence offered in the first round of the proceedings.

The nub of the examiner's decision was that the evidence in the case, which did not include any cost evidence, did not comply with the directives of the Court of Appeals in the instant case. The examiner said (folio p. 47):

> "No cost evidence or information of any kind has been offered. We thus have in the instant record no cost evidence of the type relied upon by the Commission in its *Davidor* decision, *supra*, as the basis for there approving the proposed rate increase. And it is clear that in the instant case, unlike the *Davidor* case, the record does *not* satisfy the requirements laid down by the Court of Appeals in *City of Detroit* v. *Federal Power Commission*, *supra*, that

> 'the rate base method must be used as the basis of comparison with rates proposed under another theory or method.' "

In the examiner's discussion of the issue frequent citations of the decision of the Court below and quotations therefrom will be found, and it cannot be disputed that his decision rests on the decision of the Court of Appeals in this case.

The examiner's decision in *In the Matter of Associated Oil and Gas Company, et al.*, Docket No. G-8519, *et al.*, was issued August 14, 1956. Here the evidence proved that the contract was an arm's length transaction, that the pipeline received in return for the higher price the dedication of new and additional acreage, that the price in the amended contract was no higher than that which appeared in about one-third of the contracts in effect in the area, that there were no equivalent volumes of gas available at so low a price in the area, and finally that the impact upon the consumers of the gas would be insignificant.

The examiner interpreted the case here involved in a manner somewhat different from the examiner in the *Union Oil* case. The examiner in the *Union Oil* case said that the requirement imposed by this case was that there be cost evidence in the record. While the examiner in the *Associated* case did not overlook that aspect of the Court of Appeals decision, he added that in his view the Court of Appeals meant

> "* * * that the conventional rate base method had to be used at least as a point of departure, and that any increase over and above the rates so arrived at, had to be predicated upon evidence relating to the usual needs of a regulated utility." (folio p. 28)

The examiner also found that the Commission had been consistently following the decision of the Court of Appeals in this case, referring to orders of the Commission in other cases. (folio pp. 29 and 30) Finally, the examiner said that on the evidence before him a

> "* * * finding that the proposed rates are *no more than enough* to develop the resources underlying the mutual contracts cannot be made on this record," (emphasis supplied) (folio p. 32),

and that since no such showing had been made the rate increase was not justified.

*In the Matters of Sun Oil Company, et al.*, Docket No. G-8288, *et al.*, is another examiner's decision, issued September 11, 1956, involving a case in which the applicants relied basically upon a field price presentation.

The examiner reviewed the status of the law and apparently determined to apply the doctrine of *Smyth* v. *Ames*, 169 U.S. 466, stating (folio p. 20):

> "Subsequent cases have approved methods of arriving at a reasonable rate which varied somewhat the relative weight and effect to be given the various components by which fair value is to be determined. They have not, however, destroyed the concept of *Smyth* v. *Ames* that the company devoting property to a public use is entitled to a return thereon which is based upon the fair value of the property so devoted."

He then concluded (folio pp. 23-24) that:

> "In the present case, however, the problem faced by the Applicants and which they have failed to meet by any substantial evidence is much more basic than the question of what shall be used as a rate base in these cases. They have not only presented no substantial evidence as to any suggested rate base, either determined by 'original cost', 'prudent investment', 'fair value', 'reproduction cost', 'book cost', 'reasonable value', or any other method or combination of methods. They have, in addition, made no effort to show the inadequacy of the existing rates, based upon any of the above methods or upon any other rational method.
>
> "They have proposed that regulation be accomplished by the absence of regulation and the substitution of the competitive system previously in exist-

ence in the Contract Pricing Area which producers and pipeline companies have heretofore established in Southern Louisiana."

The examiner, therefore, found (folio p. 26) that:

"The Applicants and each of them have failed to submit evidence in these consolidated proceedings, by means of which it is possible to determine either the present fair value of the respective reserves in the Egan Field, here under consideration, or the present fair value of natural gas produced in the Egan Field, as a commodity.

"In the light of the newness of the problems involved and the unsatisfactory state of both the record and the legal interpretations here involved, the public interest requires that the proceedings be dismissed without prejudice."

**Summary**

(1) In every case involving the price of produced gas, the Commission and its trial examiners are obviously struggling with the decision of the Court of Appeals in this case.

(2) The decision has caused great confusion as to the extent of the Commission's power to use commodity value in fixing the price of produced gas. In nearly every case, the uncertain and nebulous state of the applicable law is mentioned.

(3) This uncertainty, and the narrow bounds imposed on the Commission by any practical application of the decision, is a continuing barrier to proper exercise of the Commission's functions.

MOTION FILED OCT 29 1956

IN THE

# SUPREME COURT OF THE UNITED STATES.

OCTOBER TERM, 1956.

No. 98.

PANHANDLE EASTERN PIPE LINE COMPANY,
Petitioner,

v.

CITY OF DETROIT, MICHIGAN, and COUNTY OF WAYNE, MICHIGAN,
Respondents.

On Petition for Rehearing on Petition for Writ of Certiorari to the United States Court of Appeals for the District of Columbia Circuit.

## MOTION FOR LEAVE TO FILE BRIEF AMICUS CURIAE AND BRIEF.

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## INDEX.


| | Page |
|---|---|
| Motion for leave to file brief amicus curiae | 1 |
| Brief amicus curiae of Southern Natural Gas Company | 3 |
| Interest of amicus curiae | 4 |
| Reasons for granting a rehearing and issuing the writ | 4 |
| Conclusion | 7 |


### Cases Cited.


| | |
|---|---|
| Colorado Interstate Gas Company v. Federal Power Commission, 324 U. S. 581 | 6 |
| Federal Power Commission v. Hope Natural Gas Company, 322 U. S. 591 | 6 |


### Statute Cited.


| | |
|---|---|
| Natural Gas Act, Section 2 (6) | 1, 4 |

IN THE

# SUPREME COURT OF THE UNITED STATES.

OCTOBER TERM, 1956.

No. 98.

PANHANDLE EASTERN PIPE LINE COMPANY,
Petitioner,

v.

CITY OF DETROIT, MICHIGAN, and COUNTY OF WAYNE, MICHIGAN,
Respondents.

On Petition for Rehearing on Petition for Writ of Certiorari to the United States Court of Appeals for the District of Columbia Circuit.

## MOTION FOR LEAVE TO FILE BRIEF AMICUS CURIAE.

*To the Honorable, The Chief Justice and the Associate Justices of the Supreme Court of the United States:*

Comes now Southern Natural Gas Company, a corporation of the State of Delaware, with principal offices in Birmingham, Alabama, and respectfully moves, pursuant to Rule 42 of the rules of this Court, for leave to file the accompanying brief in this case as amicus curiae.

Its interest and reasons for asking leave to file a brief as amicus curiae are set forth below.

Movant is a "natural-gas company," as that term is defined in Section 2 (6) of the Natural Gas Act. It sells

natural gas, at rates which are regulated by the Federal Power Commission under the Natural Gas Act, to 88 companies, gas districts and municipalities for resale in the States of Mississippi, Alabama, Georgia, Florida and South Carolina, and produces a substantial portion of the natural gas so sold. Additionally, Movant is attempting, by exploration and development operations and acquisition of reserves, to increase its production of natural gas for use in its interstate pipeline system.

The limitations placed by the Circuit Court on the powers of the Federal Power Commission in fixing rates under the Natural Gas Act, which are at issue in this case, may directly affect Movant's future rates, and, therefore, its revenues.

The fact that the questions involved in this case affect other large natural-gas companies and the manner and the degree to which such companies will be affected can best be presented to the Court directly by the companies concerned. Movant is such a company.

The breadth and nature of the impact of this case is relevant to the importance of the questions involved, and, hence, to the disposition of the case, inasmuch as consideration of a petition for a writ of certiorari involves, in part, determination of whether the petition presents an important question.

Consent to the filing of the accompanying brief has been requested of all parties. One has consented and one has declined to grant such consent.

Respectfully submitted,

JOS. F. JOHNSTON,
H. D. McHENRY,
WILLIAM S. TARVER,
Attorneys for Movant Southern
Natural Gas Company.

IN THE

# SUPREME COURT OF THE UNITED STATES.

OCTOBER TERM, 1956.

No. 98.

PANHANDLE EASTERN PIPE LINE COMPANY,
Petitioner,

v.

CITY OF DETROIT, MICHIGAN, and COUNTY OF WAYNE, MICHIGAN,
Respondents.

On Petition for Rehearing on Petition for Writ of Certiorari to the United States Court of Appeals for the District of Columbia Circuit.

## BRIEF AMICUS CURIAE OF SOUTHERN NATURAL GAS COMPANY.

Southern Natural Gas Company respectfully requests that the Court grant rehearing on its order entered October 8, 1956, denying the petition for writ of certiorari and that a writ of certiorari issue to review the judgment of the United States Court of Appeals for the District of Columbia Circuit in the above-entitled case.

## INTEREST OF AMICUS CURIAE.

This amicus curiae is a natural-gas company, as that term is defined in Section 2 (6) of the Natural Gas Act, and sells natural gas, at rates regulated by the Federal Power Commission (Commission) under the Natural Gas Act, to 88 companies, gas districts and municipalities for resale in the States of Mississippi, Alabama, Georgia, Florida and South Carolina. During 1955, as shown by its annual report to the Commission (p. 121), it produced approximately six per cent of the natural gas used in its pipeline system. Therefore, the decision of the Circuit Court may directly affect its future rates and revenues.

## REASON FOR GRANTING A REHEARING AND ISSUING THE WRIT.

The Circuit Court has decided two important questions of Federal law which have not been, but should be, settled by this Court. Additionally, one of such questions was decided by the Circuit Court in a way which is in conflict with principles stated in applicable decisions of this Court.

First, the Circuit Court decided that the Commission, in a rate case, could not include as a component of a natural-gas pipeline company's cost of service, the commodity value of gas which the company produced, unless, by applying the rate base method as a basis of comparison, the Commission was able to find that the revenues representing the difference between the results of the two methods were no more than was needed to encourage ownership by the pipeline company of its own natural gas reserves.

Secondly, the Court below decided that the Commission was required to credit the proceeds of the sale of gasoline extracted from natural gas by a pipeline company to oper-

ating expenses, even when such extraction was not necessary for the preparation of the gas for pipeline transmission.

Both questions are of great importance to many natural gas companies and to consumers supplied with gas sold by such companies, as the Commission's opinion discloses.

This amicus curiae is vitally concerned with the first question, which will affect, probably adversely to its interest, the future determination of its rates by the Commission. When this amicus curiae last presented a rate case to the Commission, it claimed as an operating expense the commodity value, or "fair field price," of the gas it produced, in accordance with the method sanctioned by the Commission in this case, and, but for the decision of the Circuit Court, would do so in its next rate case.

That decision, however, has cast such doubt on the validity of the inclusion of the fair field price of company-produced gas (although the Court professes not to ban such inclusion) that the propriety in the future of such procedure must be questioned unless there is judicial clarification.

Although remanding the case to the Commission for the taking of evidence which would support findings equating the results of the field price method with the measure of incentive required for development of company-owned gas reserves, the Circuit Court nevertheless held that the field price method has no intrinsic validity. It logically follows, therefore, that the increase in revenues resulting from application of the field price method can be "brought into relationship by the evidence and findings with the purposes for which it is granted" only by pure coincidence.

Thus, the Commission and the regulated companies are deprived of any practical basis on which to proceed with

the fixing of rates for the sale of gas which is produced in whole or in part by such companies, unless they return to the rate base method. For it is this rate base method which the Court below states must be used, at least as an "anchor" and basis for comparison, in order "to hold the terms 'just and reasonable' to some recognizable meaning."

But such holding is in plain conflict with the statement of this Court in Federal Power Commission v. Hope Natural Gas Company, 322 U. S. 591, that "the Commission was not bound to the use of any single formula or combination of formulae in determining rates" (320 U. S. at 602). Similarly, it is in conflict with the "end result" test established in the Hope case, as is apparent since the Circuit Court acknowledged that the rates fixed by the Commission were not unreasonably high, stating: "On this record * * * we would not consider the rates so high as to be unlawful."

The case of Colorado Interstate Gas Company v. Federal Power Commission, 324 U. S. 581, suggests another reason why this is the kind of question which should be reviewed by this Court. In that case the inclusion in the company's rate base of production properties was held not to violate the Natural Gas Act, although Chief Justice Stone, in a dissenting opinion in which Justices Roberts, Reed and Frankfurter joined, was of a contrary view. But in so holding, the majority of the Court was careful to say:

> "We do not say that the Commission lacks the authority to depart from the rate base method. We only hold that the Commission is not precluded from using it" (324 U. S. at 601).

With four dissenting Justices declaring that application of the rate base method to production properties was illegal and the majority stating only that the Commission

was "not precluded" from using such method, it would be incongruous indeed if this Court now should refuse to review a case in which the Circuit Court has held that the rate base method must be used.

The decision below of the second question similarly calls for review. The holding of the Court on this point has the effect of unlawfully extending the jurisdiction of the Commission to the profits accruing from the sale of gasoline extracted from natural gas, and, therefore, in a very real sense, to such sale itself. The Natural Gas Act confers no such jurisdiction.

## CONCLUSION.

For the reasons stated, the Court should grant rehearing of its order denying the petition for writ of certiorari and should issue such writ.

Respectfully submitted,

JOS. F. JOHNSTON,
H. D. McHENRY,
WILLIAM S. TARVER,
Attorneys for Amicus Curiae, Southern Natural Gas Company.

MOTION FILED OCT 3 0 1956

IN THE

# Supreme Court of the United States

OCTOBER TERM, 1956

No. 98

PANHANDLE EASTERN PIPE LINE COMPANY, *Petitioner*

v.

CITY OF DETROIT, MICHIGAN, AND
COUNTY OF WAYNE, MICHIGAN, *Respondents*

On Petition for Rehearing on Petition for Writ of Certiorari to the Court of Appeals for the District of Columbia Circuit

## MOTION FOR LEAVE TO FILE BRIEF AMICUS CURIAE, AND BRIEF

INDEPENDENT NATURAL GAS ASSOCIATION OF AMERICA

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*Chairman, Legal Committee*

PRESS OF BYRON S. ADAMS, WASHINGTON, D. C.

IN THE

# Supreme Court of the United States

OCTOBER TERM, 1956

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No. 98

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PANHANDLE EASTERN PIPE LINE COMPANY, *Petitioner*

v.

CITY OF DETROIT, MICHIGAN, AND
COUNTY OF WAYNE, MICHIGAN, *Respondents*

---

**On Petition for Rehearing on Petition for Writ of Certiorari to the Court of Appeals for the District of Columbia Circuit**

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## MOTION OF INDEPENDENT NATURAL GAS ASSOCIATION OF AMERICA FOR LEAVE TO FILE BRIEF AMICUS CURIAE

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TO THE HONORABLE, THE CHIEF JUSTICE AND THE ASSOCIATE JUSTICES OF THE SUPREME COURT OF THE UNITED STATES:

The Independent Natural Gas Association of America respectfully applies to this Court for leave to file a brief as an amicus curiae in the above entitled action, and submits that it satisfies the requirements respecting eligibility for such leave provided in Paragraph 3 of Rule 42 of this Court's Rules, on the following grounds:

1. Petitioner has consented to the applicant's filing of a brief amicus. The respondents have withheld consent on the ground that this Court is not in favor of such briefs and on the assertion that the position of

the industry will be adequately represented by petitioner.

2. The questions presented by the above entitled action are:

(1) Whether the Federal Power Commission in determining just and reasonable rates may in its considered judgment depart from a rate base method to the extent of valuing as a commodity the natural gas produced by a natural gas company.

(2) Whether the Federal Power Commission, upon a finding that gasoline extraction and sale is a separate and distinct business from transportation and sale of natural gas for resale, is required as a matter of law to credit revenues from such gasoline extraction and sale to the jurisdictional business of transporting and selling natural gas for resale.

(3) The larger question relating to administrative processes generally is whether a Court of Appeals may freeze into law a method or formula for administrative rate determinations which was itself nothing more nor less than an administrative policy heretofore repeatedly accepted by this Court as administratively permissible but not mandatory.

**3. Interest of Independent Natural Gas Association**

(a) The Independent Natural Gas Association of America is a private corporation organized and existing under the laws of Delaware. It has a membership of approximately 1,600 members located in nearly every state of the Union including all natural gas producing states and all natural gas consuming states. Its membership includes producers, royalty owners, transporters, (intrastate and interstate) and distributors of natural gas, as well as those engaged in related activities of

financing and manufacturing. Among its members are included virtually all of the interstate transmission pipeline companies subject to the regulatory jurisdiction of the Federal Power Commission and many of the producers of natural gas who were first decided to be subject to that regulatory jurisdiction by the decision of this Court in the *Phillips Petroleum Company case*, (347 U.S. 672) on June 7, 1954.

(b) The principal business objectives and purposes of the Association as set forth in its charter are to promote and advance the welfare, progress and development of the natural gas industry. One of the incidental but important methods for advancing its objectives is participation as an interested party or as amicus curiae in litigation and administrative proceedings involving issues which may have an important effect upon the industry generally.

(c) The Independent Natural Gas Association and its members have a keen interest in the instant case because of its concern with the integrity of administrative processes and particularly the discretionary powers of the Federal Power Commission in its administration of the Federal Natural Gas Act.

#### 4. Reasons for Submission of Brief

Since the passage of the Natural Gas Act this Court has exercised its discretion on certiorari by taking jurisdiction and deciding a number of cases arising under the Act. However, in deference to this Court's Rule which specifies that motions of this nature are not favored, movant has seldom submitted amicus briefs. On only three occasions prior to this has this Association believed the issues involved in matters before this Court to be of such widespread and overwhelming importance to the industry and to the gen-

eral public that it felt compelled to submit its views for consideration by this Court.

Movant has very carefully considered the issues presented and believes that the decision of the Court of Appeals is counter to the principles which have been enunciated by this Court with respect to the discretionary powers of the Federal Power Commission in carrying out its functions and duties in the administration of the Natural Gas Act.

It is appropriate that this Court have before it the views of an organization representing a substantial portion of the federally regulated industry. The importance which this case has upon the entire natural gas industry cannot be overemphasized. It is of importance to the future availability of future natural gas supplies for millions of consumers. The decision below, if allowed to stand, becomes more than a precedent for the regulation of members of this industry. It is a direction to the Federal Power Commission as to its future course in its important rate regulation under the Natural Gas Act, which may bind not only its actions with respect to pipeline transmission companies, but also those thousands of producers of natural gas who are now subject to the rate regulatory jurisdiction of the Federal Power Commission.

It is respectfully requested on the above grounds that this application for leave to file a brief as amicus curiae be granted.

Respectfully submitted,

INDEPENDENT NATURAL GAS ASSOCIATION OF AMERICA

SCOTT HUGHES
*Attorney for Movant*

IN THE

# Supreme Court of the United States

OCTOBER TERM, 1956

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No. 98

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PANHANDLE EASTERN PIPE LINE COMPANY, *Petitioner*

v.

CITY OF DETROIT, MICHIGAN, AND
COUNTY OF WAYNE, MICHIGAN, *Respondents*

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## BRIEF AMICUS CURIAE

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The Independent Natural Gas Association of America, as amicus curiae, respectfully requests that the Court grant a rehearing of its order entered October 8, 1956, denying the petition for writ of certiorari, and that a writ of certiorari issue to review the judgment of the Court of Appeals for the District of Columbia Circuit in the above entitled case.

This Association represents among its membership, producers, gatherers, land and royalty owners, transporters, and distributors of natural gas. Also financial institutions and suppliers of equipment. This is the sixth largest industry in the United States in terms of

investment and serves over 24 million consumers. More than 195 thousand persons are directly employed in natural gas operations with additional thousands in allied industries dependent upon this industry. Insurance companies entrusted with the savings of millions of policyholders are the largest class of investors in this industry.

The soundness of the industry, the protection of its investors, and the future service to millions of consumers are largely dependent upon the integrity of the regulatory processes under which this industry exists and operates. This industry is slowly recovering from the extraordinary adjustments necessitated by this Court's decision of June 7, 1954 in the *Phillips Petroleum Company case*, (347 U.S. 672). The state of confusion which persisted throughout the industry for many years prior to that decision, well known to this Court, was detrimental to the interests of the entire industry as well as to natural gas consumers. The adjustments in the regulatory processes and within the industry required by that decision have by no means reached a point of firmness or stability. The Court of Appeals' decision here imposes new restrictions, restraints and criteria, upon the regulatory processes and the industry, the validity of which should be passed upon by this Court.

The fact that this Court has on so many occasions taken jurisdiction over questions involving the Natural Gas Act indicates that this Court recognizes the public importance of such questions as justification for certiorari and convinces us that in denying the petition for writ of certiorari in this case the Court has overlooked or not fully comprehended the character and importance of the questions presented.

**Basic Facts**

The Federal Power Commission Order of April 15, 1954 prescribed certain rates and charges for the sale by Panhandle Eastern Pipe Line Company of natural gas in interstate commerce for resale. In this Order the Commission departed from the traditional rate base approach to the extent of using a different method or formula for valuing Panhandle's own gas production. A commodity value was computed for this gas based upon the weighted average arms length prices for similar gas in the same fields in which produced. This weighted value was multiplied by the volume Panhandle produced and the resulting figure was included in operating expenses as the amount to be recovered by Panhandle through its rates. The cost of the producing properties was excluded from the rate base and the costs of production were excluded from operating expenses. The Commission also excluded from pipeline operating expenses the net revenues received by Panhandle from gasoline extraction because gasoline extraction was found to be a separate business unnecessary to the pipeline's operation.

On review the Court of Appeals for the District of Columbia Circuit set aside the Commission's Order with respect to commodity value and gasoline extraction, and remanded the case. In so doing, the Court directed that the starting point, or point of departure for any natural gas company rate proceeding is original cost. The Court directed the Commission as a matter of law to first determine costs. The Court made no distinction between pipeline facilities and producing properties. The Court also required the Commission as a matter of law to credit all the revenues from gasoline extraction to the cost of transporting and

selling gas for resale. The Court did not expressly find the rates fixed by the Commission to be unjust or unreasonable.

**Reasons for Granting a Rehearing and Issuing the Writ**

The petition for certiorari in the above entitled cause discloses the kind of questions which this Court has indicated by its rules and by its decisions as proper for it to consider. The Court of Appeals for the District of Columbia Circuit has decided important questions of federal law which have not been, but should be, settled by this Court. This is the first case to reach this Court raising the question of whether or not the Federal Power Commission may in its discretion partially or wholly depart from the original cost depreciated rate base method in determining just and reasonable rates for a natural gas company. This is the first case to reach this Court raising the question of whether or not the Federal Power Commission is required to credit revenues to operating costs, for gasoline extraction operations which are a separate business from the transportation and sale of natural gas in interstate commerce. This is the first case to reach this Court involving the question of whether a Federal Court may reverse a rate determination of the Federal Power Commission without finding that rate determination to be unjust or unreasonable. This is the first case to reach this Court raising the question of whether a Federal Court may properly require an administrative agency of the Federal Government to adhere to a single formula or method for rate determination which formula or method was originally adopted by the administrative agency in its discretion.

While there may be many types of cases and administrative determinations which should properly be left for conclusive decision by a Court of Appeals, novel questions of widespread importance to a major industry, to the public, and to the proper function of an important Federal regulatory agency require authoritative decision by the highest Court. The Court's decision below if allowed to stand, will have a decided impact upon the natural gas industry and its regulation in compounding the great confusion and indecision which has already existed through conflicts of administrative and court rulings respecting the jurisdiction of the Federal Power Commission over independent producers and gatherers of natural gas. The necessity for an authoritative decision and direction to the administrative body by this Court is of special importance where there exist grave questions as to whether the Court below has in its conclusions adhered to the prior decisions of this Court.

An additional reason why this Court should consider the questions involved in this case is the fact that for all practical purposes, if this writ is not granted on rehearing, the natural gas industry and Federal Power Commission may be precluded from ever bringing these questions before this Court in another case, in the absence of intervening congressional action. This is because the questions presented arise from the exercise of administrative discretion. If the Court of Appeals' decision is allowed to stand, the Federal Power Commission will be powerless to exercise discretion on the matters involved in this case, and the industry will be powerless to seek review on the failure of the Power Commission to apply such discretion. The circumscribing of administrative discre-

tion in this case may also affect the right of other Federal administrative agencies to change discretionary policies which experience prove outmoded.

This Court has on several occasions ruled with respect to the validity of the Federal Power Commission action in using an original cost depreciated formula in determining just and reasonable rates for natural gas pipeline companies. It might be well to briefly review some of the circumstances preceding the adoption of this method by the Federal Power Commission and its approval by this Court. Until June 7, 1954, the date of the decision by this Court in the *Phillips Petroleum Company* case, the Federal Power Commission regulated gas production only when owned by a transmission company or its affiliate. In all of the Commission's rate cases up to April 15, 1954, the date of the Commission's decision in this case, investment in transmission facilities of natural gas pipelines was so overwhelmingly greater than investment in producing facilities of those pipelines that a just and reasonable rate under the Natural Gas Act produced by the application of the rate base approach for natural gas pipeline companies could not be proved to produce an unreasonable end result as to the rates paid by distribution companies at the town borders, even if the gas produced by the transmission companies was established under the rate base formula to a negative cost. The cost concept was considered by the administrators of regulation to be such an improvement over the previous reproduction or fair value scheme of regulation, that it was embraced as containing the solution for all known regulatory rate problems. This, notwithstanding the fact that Mr. Justice Brandeis, the author of the legitimate cost theory, had substantial

reservations concerning its applicability and workability in the production field.

The Federal Power Commission had not foreseen during the early years of the Natural Gas Act that regulation of the production portion of the gas industry by the same cost approach as was used for conventional utilities generally, would produce results detrimental to the public interest, to investors, and most important, to the search for additional reserves of gas. The Commission could not know in the early years of the administration of the Gas Act that by June 7, 1954, it would have jurisdiction over rates or prices charged by a very substantial portion of the gas producing industry. Up to June 7, 1954, the Commission firmly believed that it had jurisdiction over only a very small portion of the gas producing industry and then only when gas producing property was owned by a pipeline company whose investments in pipeline facilities totally overshadowed its investments in gas producing facilities. During that period the Commission either was unaware or did not understand the irrationality of applying the cost theory to gas producing properties, or if it was fully understood, it was believed that any harm was more than offset by the total benefit to the public good which was believed to have been achieved by the application of the cost doctrine to the larger and more important gas transmission properties with which pipeline producing properties were combined.

It was in the light of this background that the *Hope* case,[1] the *Natural Gas Pipeline Company* case[2] and the *Colorado Interstate* case[3] were decided by the

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[1] *FPC* v. *Hope Natural Gas Company*, 320 U.S. 591.

[2] *FPC* v. *Natural Gas Pipeline Company*, 215 U.S. 575.

[3] *Colorado Interstate Gas Company* v. *FPC*, 324 U.S. 581.

Commission and were upheld by this Court. This Court has repeatedly upheld the power of the Commission to use the original cost depreciated rate base, but has repeatedly said that the Commission is not required to do so. The questions which have come before this Court involving the validity of original cost rate base have raised confiscation questions under the Due Process Clause of the Constitution. They have been concerned with how little the Federal Power Commission could constitutionally allow, not how much.

By April 15, 1954, the injury being done by the indiscriminate and rigorous application of the cost concept to natural gas production had become so grave that it could no longer be considered an incidental part of the larger and more important gas transmission properties. Furthermore, the Court of Appeals had already concluded that the independent producing segment of the natural gas industry was to be regulated by the Federal Power Commission. None of the new natural gas pipelines built under Federal Power Commission certificates after the passage of the Natural Gas Act of 1938, owned substantial gas reserves because the companies could not afford the risk of placing reserves of natural gas under the jeopardy of regulation by the cost method. Since cost of producing gas could be, and on several occasions had been found to be a negative figure, the owner of large gas reserves would not only face the hazard of giving away his reserves if he permitted them to become a part of the pipeline project, but might well find that by doing so he was establishing an arrangement whereby he would be compelled in effect to pay the consumer for using up his reserves of gas. This could arise through the process of conveying to consumers the tax benefits

which Federal tax laws allow to natural gas and other natural resource producers.

The Federal Power Commission recognized that the cost system of regulation which it had employed up to the time of its decision in the case before you, while perhaps achieving the lowest possible immediate price for gas, was creating many other undesirable and harmful consequences upon the public good, primarily in relation to destroying the incentive for discovery and development, and the committing of reserves to interstate markets. In its view it had become necessary so far as the production portion of the gas business was concerned, to abandon the cost approach. Present experience of the Federal Power Commission in carrying out its duties under the Natural Gas Act and the decision of this Court in the *Phillips Petroleum Company* case, is exemplifying the fantastic results of attempts to use investment costs for valuing gas production either for determining rates of producers, or as a basis for departure or of comparison.

This Court has approved the prudent investment method or the end result method in testing the constitutional validity of rates. It has not reviewed the authority (heretofore believed to be exclusive) of the Commission in fixing just and reasonable rates above a barely non-confiscatory rate. The Court of Appeals has here said that the Commission may consider factors such as the need for encouraging exploration and development of gas resources, but if it increases rates above the bare non-confiscatory rate it "must see to it that the increase is in fact needed, and is no more than is needed for the purpose". The criteria set forth requires a preciseness of proof which if not impossible, has never yet been achieved even with respect to the cost method.

The Court of Appeals has injected into the Commission's functions a new and novel theory, namely that although the Commission is not required to use the conventional rate base method for fixing rates, yet it is required that such method be used as a basis for comparison or at least for a point of departure. By this holding, the Court of Appeals, instead of clarifying the Commission's functions has further complicated and restricted the Commission in a manner not sanctioned by the Natural Gas Act, or by the decisions of this Court. This Court has made it clear that even in the confiscation cases, the Commission is not required to select a rate base or any other particular formula or combination of formulae for fixing rates. But here, the Court of Appeals has held that the rate base formula must be used, perhaps not for fixing rates, but for "basis of comparison" or "point of departure". Just how this basis for comparison is to be made is not quite clear. The record in this case shows the fantastic results of attempting to use any such comparison. The Federal Power Commission in current proceedings involving producers' rates is encountering more fantastic results and impossible situations in attempting to use the rate base method for comparison purposes as required by the opinion of the Court of Appeals.

There is nothing in the Natural Gas Act which deals with "points of departure" and the Supreme Court has expressly held that even in determining the "lowest reasonable rate" below which the Commission must not go, the Commission is not bound to the use of any single formula or combination of formulae. The requirement of the Court of Appeals that the Commission determine a rate base for purposes of comparison or a point of

departure appears to be judicial legislation, and a usurpation by that Court of matters that are within the exclusive and final jurisdiction of the Commission even as applied to the production from its own wells by natural gas transmission lines.

## CONCLUSION

For the foregoing reasons the Independent Natural Gas Association of America respectfully urges that the Order of this Court denying certiorari to the Court of Appeals for the District of Columbia Circuit be reheard and vacated and that the petition be granted.

Respectfully submitted,

INDEPENDENT NATURAL GAS ASSOCIATION OF AMERICA

SCOTT HUGHES
Burt Building
Dallas, Texas
*Chairman, Legal Committee*

October 30, 1956.

FILED
NOV 1 1956
JOHN T. FEY, Clerk

In the

# Supreme Court of the United States

OCTOBER TERM, 1956

No. 98

PANHANDLE EASTERN PIPE LINE COMPANY,
*Petitioner,*

*v.*

CITY OF DETROIT, MICHIGAN, and
COUNTY OF WAYNE, MICHIGAN,
*Respondents.*

## MOTION OF H. F. SEARS AND A. E. HERRMANN CORPORATION FOR LEAVE TO FILE AMICI CURIAE BRIEF IN SUPPORT OF PETITION FOR REHEARING OF ORDER DENYING PETITION FOR WRIT OF CERTIORARI.

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## MOTION OF H. F. SEARS AND A. E. HERRMANN CORPORATION FOR LEAVE TO FILE AMICI CURIAE BRIEF IN SUPPORT OF PETITION FOR REHEARING OF ORDER DENYING PETITION FOR WRIT OF CERTIORARI.

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H. F. SEARS and A. E. HERRMANN CORPORATION, independent producers of natural gas, respectfully file this Motion for Leave to File an Amici Curiae Brief in support of Petition for Rehearing of this Court's order of October 8, 1956, denying Petition for Writ of Certiorari

in Cause No. 98 on the docket of this Court. In support of such motion, movants respectfully show:

1. Consent has been obtained from petitioner for the filing of such brief; but, although requested to do so, respondents have refused to agree that it may be filed.

2. Movants' interest is that they are independent producers of gas in the Panhandle Gas Field who now have pending before an Examiner of the Federal Power Commission proceedings for the purpose of determining whether increased contract rates for gas sold by them to an interstate pipeline company are just and reasonable within the meaning of Section 4(e) of the Natural Gas Act [15 U. S. C. 171c(e)].[1]

The situation which faces these producers is typical of that which faces many such producers at this time and will continually arise when consideration is hereafter given by the Commission to rates of other independent producers.

3. In its opinion of December 15, 1955, reported at *230 F. 2d 810*, the Court of Appeals has, among other things, announced that in rate proceedings under the Natural Gas Act, the Commission *must* determine a reasonable price by use of the conventional rate-base method for purposes of comparison or as a point of departure.

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[1]It is not contended by such producers that rates existing prior to the execution of contracts providing for such increased rates were confiscatory.

It is believed by these producers that the Natural Gas Act is not subject to the interpretation so given it by the Honorable Court of Appeals; and that in such holding the Court of Appeals has invaded the field which by the Natural Gas Act is placed in the exclusive jurisdiction of the Federal Power Commission.

4. In the proceedings now pending before the Examiner of the Federal Power Commission involving increased rates of these producers, it is argued by counsel who also represents one of the respondents in this case that under the opinion of the Court of Appeals of December 15, 1955, a just and reasonable rate can be ascertained only by using the rate-base method for purposes of comparison or as a point of departure, and, therefore, that evidence from which a rate may be derived through use of a rate base *must* be produced before the Commission can consider the reasonableness of proposed increases in rates. This contention has also been made in other cases pending before the Commission. The opinion of the Court of Appeals has an impact, therefore, far beyond the immediate parties to this proceeding.[2]

5. The impact of such opinion of the Court of Appeals on independent producers of gas has not adequately been presented in briefs heretofore filed with the Court, and it is believed that the parties to the proceedings are not in position adequately to show such impact.

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[2]The propriety of a suggestion by amicus curiae as to the effect of a holding on parties not before the Court was recognized in *Green v. Biddle*, *8 Wheat. 1, 18; 5 L. Ed. 547, 552.*

The undersigned submit with this application the amici curiae brief which they desire to file, and request that the Court permit the filing thereof.

Respectfully submitted,

D. H. CULTON,
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NOV 1 1956
JOHN T. FEY, Clerk

IN THE

# Supreme Court of the United States

October Term, 1956

No. 98

PANHANDLE EASTERN PIPE LINE COMPANY,

*Petitioner*

V.

CITY OF DETROIT, MICHIGAN, AND COUNTY OF WAYNE, MICHIGAN,

*Respondents*

## AMICI CURIAE BRIEF OF THE STATE OF TEXAS, IN SUPPORT OF PETITION FOR REHEARING OF ORDER DENYING PETITION FOR WRIT OF CERTIORARI.

JOHN BEN SHEPPERD
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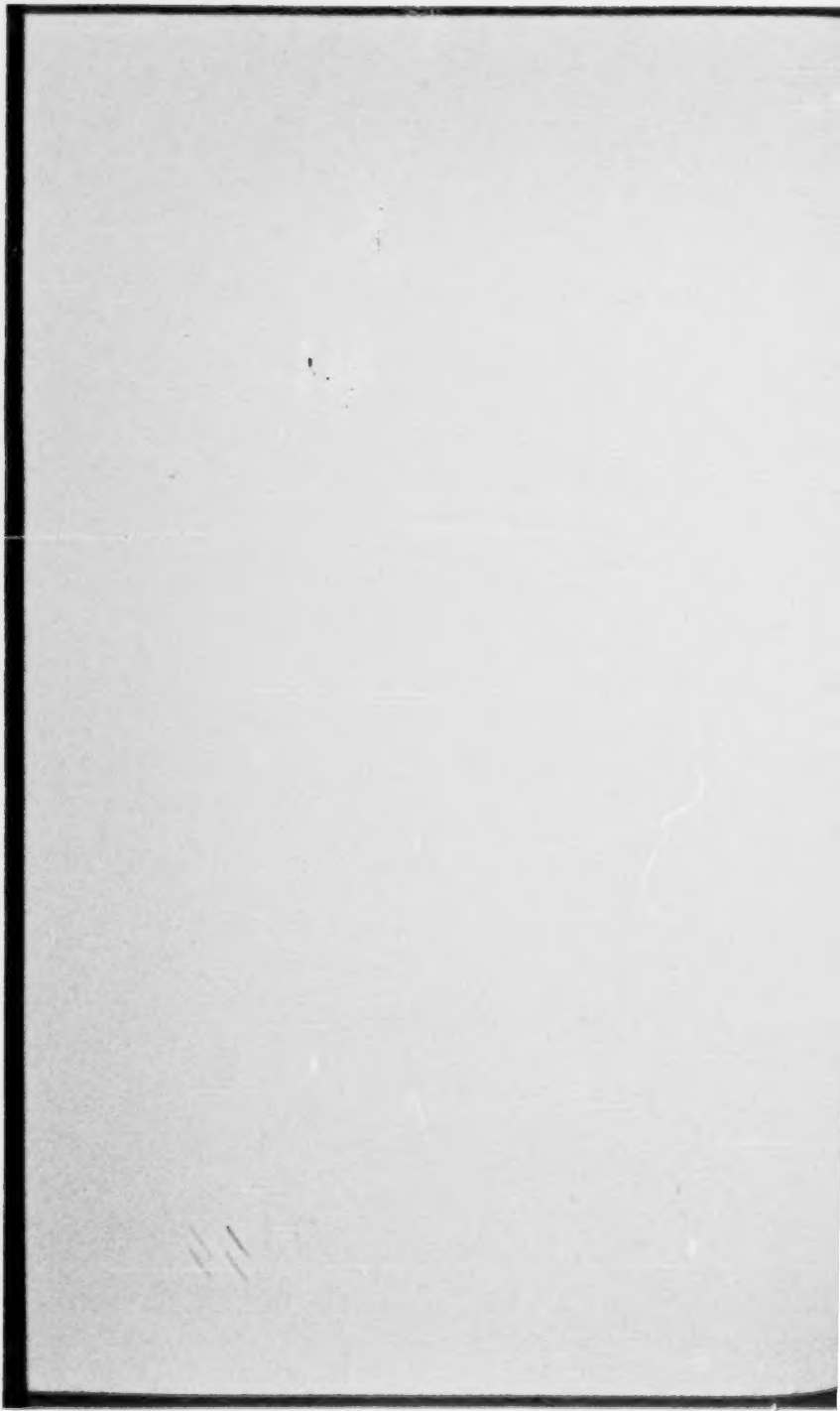
AMICI CURIAE



IN THE

# Supreme Court of the United States

October Term, 1956

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No. 98

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PANHANDLE EASTERN PIPE LINE COMPANY,

*Petitioner*

V.

CITY OF DETROIT, MICHIGAN, AND COUNTY OF WAYNE, MICHIGAN,

*Respondents*

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## AMICI CURIAE BRIEF OF THE STATE OF TEXAS, IN SUPPORT OF PETITION FOR REHEARING OF ORDER DENYING PETITION FOR WRIT OF CERTIORARI.

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To The Honorable Supreme Court of the United States:

JOHN BEN SHEPPERD, Attorney General of the State of Texas, and MERT STARNES, Assistant Attorney General, acting herein on behalf

of the State of Texas and at the request of the Railroad Commission of the State of Texas, respectfully as amici curiae file this brief in support of the Application of Panhandle Eastern Pipe Line Company, petitioner in the above styled cause, for Rehearing of the Order of this Court, entered October 8, 1956, Denying Petition for Writ of Certiorari.

## I.

The undersigned do not hereby undertake to advocate any particular form of rate-structure fixing, but consider that to be the function of the Federal Power Commission. It is believed, however, that the impact of the opinion of the Court of Appeals for the District of Columbia in its opinion of December 15, 1955, reported at 230 F. 2d 810, in the producing areas, not only on producers of gas, independent and others, but also on royalty owners and the states themselves, justifies a suggestion by the legal representatives of the State of Texas that it is in the public interest that such opinion of the Court of Appeals be reviewed by this Court, and that this Court, after full hearing, determine whether in such opinion that Court has properly interpreted the Natural Gas Act.

## II.

The State of Texas, its Railroad Commission, its producers of gas, its royalty owners, and its citizens generally are vitally interested for the following reasons:

(1) The State of Texas is one of the major producers of gas in the nation. Its Railroad Commission has jurisdiction over approximately sixteen thousand gas wells and many thousands of oil wells which produce casinghead gas in great quantities. At least twenty-nine interstate pipelines transport gas from the State of Texas, supplying with Texas gas portions of at least thirty-five states.

During the year 1955 approximately four trillion cubic feet of natural gas and approximately one and one-half trillion cubic feet of casinghead gas were produced within the state, of which approximately two and one-half trillion cubic feet were transported to other states by the interstate pipelines referred to. The gas not so transported was used within the state—in part for chemical purposes, in part for carbon black manufacture, and in part for heat and fuel purposes.

A large portion of the people of the state, being producers and royalty owners, are vitally affected by any action, legislative, administrative or judicial, which affects the oil and gas industry.

(2) A large portion of the revenues of the state ($41,425,801 for the year ending August 31, 1956) is derived from the state's production or severance tax. That tax is fixed at a percentage of the value of gas at the wells, and, in cases where sales are made at the wells, a percentage of the price there received.

(3) The State of Texas itself, for its various funds, is the owner of minerals under approximately fourteen million acres of land, of which more than four million acres have been leased for oil and gas production under contracts which provide for the payment to the state of a royalty on oil and gas produced therefrom.

## III.

The opinion of the Court of Appeals of the District of Columbia is interpreted by the undersigned as holding that the Federal Power Commission when fixing rates of a pipeline transportation company for its own produced gas *must*, in valuing such gas at the point of production, fix a rate by the conventional rate-base method for use as a basis for comparison or as a point of departure; that this is a requirement of the Natural Gas Act.

The undersigned do not consider it to be their function here to discuss their view of the proper interpretation of the Natural Gas Act or what the Power Commission should do in its administration. They do, however, believe it proper to direct the Court's attention to the fact that the impact of the opinion of the Court of Appeals goes far beyond the parties to the immediate case; that those affected thereby are not only the pipeline companies and consumers of gas but also independent producers who have no transportation facilities, royalty owners and the producing states in their revenues from taxes and royalties.

It is believed, therefore, that the case is of such broad national interest as to justify the granting of a writ of certiorari and a final and authoritative determination by this Court as to whether the Court of Appeals has properly interpreted the Natural Gas Act.

## IV.

It is, of course, recognized that this Court has many times made it clear that a refusal of a writ of certiorari does not constitute an approval by this Court of what was held by the Court below; also, that ordinarily a writ is not granted where a proceeding has been remanded for further action.

Here, however, the Court of Appeals has given to the Natural Gas Act an interpretation which will be fundamental to the further conduct of this case. *United States v. General Motors Corp.*, 323 U. S. 373, 379. Presumably it will be followed by the Commission when dealing with rates of other pipeline companies and the thousands of independent producers of gas. Not until sometime in the future when this or some other case reaches this Court will an opportunity arise for this Court to give a definitive interpretation of the Act.

It is, therefore, respectfully suggested that the application for writ of certiorari be granted in order that this Court, because of the wide public interest involved, may determine definitively

whether the Court of Appeals has properly interpreted the requirements of the Natural Gas Act in the particulars referred to.

JOHN BEN SHEPPERD
Attorney General of Texas
Austin, Texas

MERT STARNES
Assistant Attorney General
Austin, Texas

AMICI CURIAE

## Certificate of Service

I, John Ben Shepperd, Attorney General of the State of Texas and a member of the Bar of the Supreme Court of the United States, hereby certify that on the 30th day of October, 1956, I served a copy of the foregoing Brief Amici Curiae by depositing the same in a United States post office, with air mail postage prepaid, duly addressed to one of the attorneys of record for each of the parties hereto, as follows:

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John Ben Shepperd

JOHN BEN SHEPPERD

NOV 1 1956
JOHN T. FEY, Clerk

IN THE

# Supreme Court of the United States

OCTOBER TERM, 1956

No. 36

PANHANDLE EASTERN PIPE LINE COMPANY, *Petitioner*,

v.

CITY OF DETROIT, MICHIGAN, AND COUNTY OF WAYNE, MICHIGAN, *Respondents*

On Petition for Rehearing on Petition for Writ of Certiorari to the Court of Appeals for the District of Columbia Circuit

## BRIEF AMICUS CURIAE OF THE STATE CORPORATION COMMISSION OF THE STATE OF KANSAS

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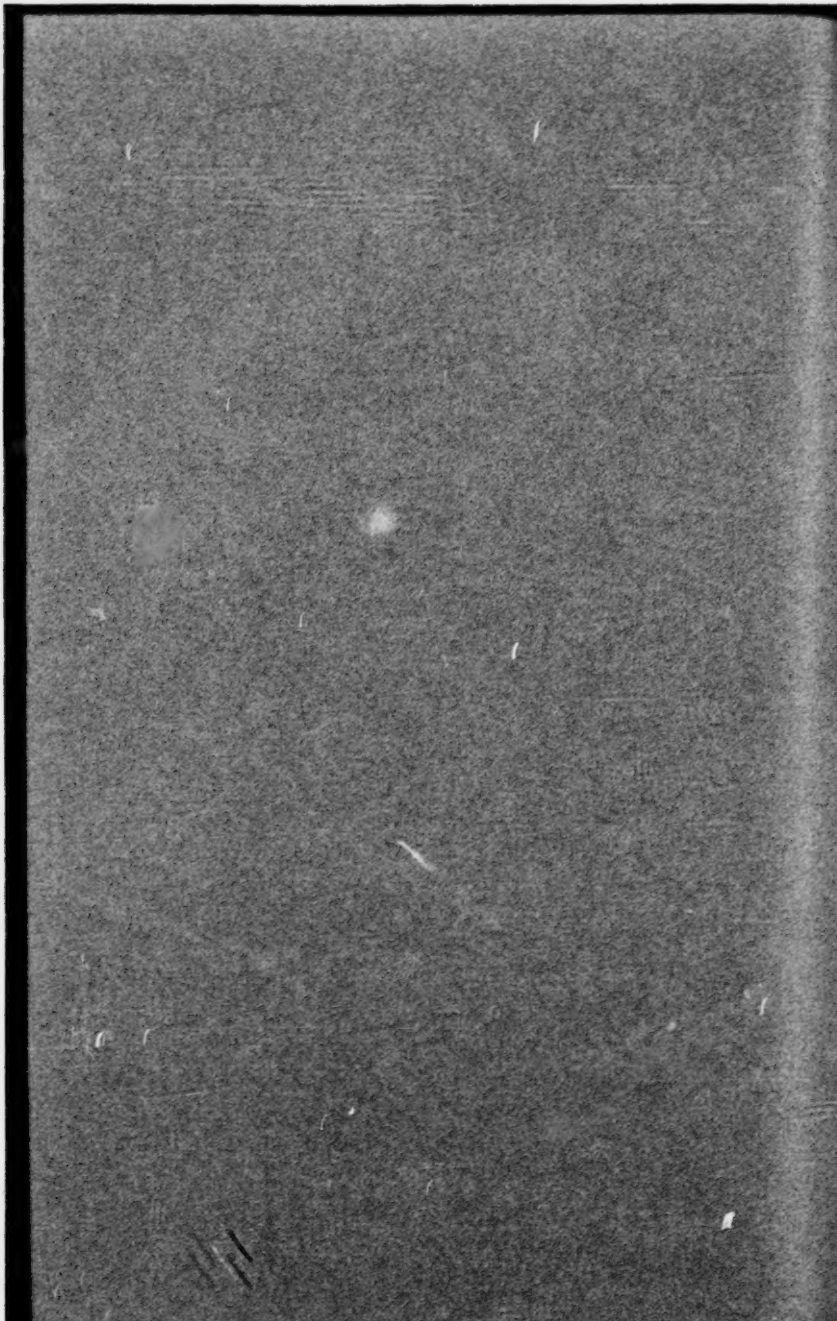

## INDEX


| | Page |
|---|---|
| Purpose of This Brief | 2 |
| Commodity Value | 2 |
| Natural Gas Reserves | 2 |
| Extraction Operations | 3 |
| Conclusions | 4 |


## TABLE OF CASES


| | |
|---|---|
| Federal Power Commission v. Natural Gas Pipe Line Company, 315 U.S. 575, 586 | 4 |


## STATUTES


| | |
|---|---|
| G. S. of Kansas 1949, 55-705a | 4 |

IN THE

# Supreme Court of the United States

OCTOBER TERM, 1956

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No. 98

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PANHANDLE EASTERN PIPE LINE COMPANY, *Petitioner,*

v.

CITY OF DETROIT, MICHIGAN, AND COUNTY OF WAYNE, MICHIGAN, *Respondents*

---

**On Petition for Rehearing on Petition for Writ of Certiorari to the Court of Appeals for the District of Columbia Circuit**

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## BRIEF AMICUS CURIAE OF THE STATE CORPORATION COMMISSION OF THE STATE OF KANSAS

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The State Corporation Commission of Kansas, the body charged by statute with the responsibility of administering the oil and gas conservation laws of said state, files this Brief Amicus Curiae under Rule 42 of this Court, and urges the Court to grant a rehearing of its order of October 8, 1956, denying certiorari, and upon rehearing to issue a writ of certiorari to review the judgment of the United States Court of Appeals for the District of Columbia Circuit.

## PURPOSE OF THIS BRIEF

The State Corporation Commission is interested in this proceeding to the end that it may faithfully and properly discharge the duties imposed upon it by the laws of the State of Kansas, particularly with reference to the production and conservation of the natural gas resources of that State, which the statute requires it to regulate so as to accomplish the prevention of waste, the protection of correlative rights, and the orderly development in and of the various reservoirs or common sources of supply within the State.

## COMMODITY VALUE

It is essential to effective conservation and orderly development of the natural gas resources of Kansas that the producer be allowed to receive a fair and reasonable commodity value for the gas produced.

As early as 1946, the State Corporation Commission of Kansas in effect took the same position that it now takes with respect to the use of commodity value in the pricing of natural gas.

Gas is a real commodity; and, if a real commodity has a low value, the inevitable result is waste. The truth of this statement is evidenced by the thousands of empty reservoirs throughout the United States, which are now nothing more than a symbol of the wastefulness and neglect of past generations. No amount of wishful thinking can ever reproduce or recover this valuable natural resource so foolishly wasted.

## NATURAL GAS RESERVES

As heretofore stated, one facet of this Commission's statutory duties is to promote orderly development in and of the various common sources of supply. Several interstate pipeline companies operating in Kansas produce and also purchase natural gas from the various fields. The ratio of produced gas to purchased gas is steadily declining at an alarming rate.

The ownership of reserves by pipeline companies has a stabilizing influence upon the market and is beneficial to the ultimate consumer. The incentive to acquire and maintain reserves by the recognition of the commodity value of gas should be preserved.

The transmission companies were pioneers in the natural-gas industry and were faced with the competitive prices of coal and oil, and any investment at all was made at great risk. These risks were undertaken by private capital, and no part of the risk was borne by the ratepayer. To distinguish between gas which is produced from transmission companies' reserves and that which is purchased from other independent producers under "arms-length" contracts would force the companies which own their own reserves to neglect exploration of new reserves.

There are three main advantages to the pipeline, and to the consumer, when the gas reserves are owned by the transmission company; namely, (1) the pipeline is in a better bargaining position when it comes to negotiating gas-purchase contracts at arms-length with independent producers, (2) the pipeline can take care of variation in demand by increasing or limiting withdrawals from its own reserves, and (3) the pipeline can limit the volume of gas deliveries due to conservation restrictions. These three advantages allow a natural-gas company which owns a portion or all of its own supply to retain an economic, uniform and reliable service to the consuming public.

The incentive for pipeline companies to acquire their own reserves has largely been destroyed by the rate-base approach. The extension thereof to independent producers will have the same unwholesome effect; the long-range interests of the consumer will be thwarted; and the conservation program of Kansas will be impeded.

## EXTRACTION OPERATIONS

The State Corporation Commission is further concerned in the instant matter as it relates to the treatment accorded

gasoline extraction operations by the court below. G. S. of Kansas 1949, 55-705a, requires notice and hearing before the Commission may issue a certificate for the construction and operation of gasoline extraction facilities. Such operations are clearly incidents of the production and gathering of natural gas, which have been left exclusively to state regulatory bodies and excluded from the jurisdiction of the Federal Power Commission as that Commission held in the instant case based on the evidence and record before it. The inquiry should end at this point. (*Federal Power Commission* v. *Natural Gas Pipe Line Company*, 315 U.S. 575, 586.)

## CONCLUSIONS

The continuation of complete and unhampered jurisdiction over the activities of production and gathering within the State of Kansas by the State Corporation Commission is essential to the efficient exercise of its duty to prevent waste and conserve natural gas. A fair and reasonable commodity value for natural gas is essential to conservation and promotes exploration and development.

We respectfully urge that this court grant the petition for rehearing of its order of October 8, 1956, denying certiorari, and upon rehearing issue a writ of certiorari to review the judgment of the United States Court of Appeals for the District of Columbia Circuit.

Respectfully submitted,

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FILED
NOV 2 1956
JOHN T. FEY, Clerk

In the

# SUPREME COURT OF THE UNITED STATES

OCTOBER TERM, 1956

## No. 98

PANHANDLE EASTERN PIPE LINE COMPANY,
*Petitioner,*

VERSUS

CITY OF DETROIT, MICHIGAN AND
COUNTY OF WAYNE, MICHIGAN,
*Respondents.*

**On Petition for Rehearing on Petition for Writ of Certiorari to the Court of Appeals for the District of Columbia Circuit**

## BRIEF AMICUS CURIAE OF THE CORPORATION COMMISSION OF THE STATE OF OKLAHOMA

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October, 1956.

UTTERBACK TYPESETTING CO., 13 SO. WALKER, OKLAHOMA CITY, PH. FO 8-8780

# INDEX


| | PAGE |
|---|---|
| Purpose of This Brief | 2 |
| Decision of the Court Below | 3 |
| The Original Cost Formula and Its Destructive Effect Upon Correlative Rights | 4 |
| The Field Price Formula | 6 |
| Conclusion | 7 |


## CITATIONS

CASES:


| | |
|---|---|
| Phillips Petroleum Company v. State of Oklahoma, 340 U.S. 190 | 5 |
| Phillips Petroleum Company v. Wisconsin, 347 U.S. 672 | 2 |

In the
Supreme Court of the United States
OCTOBER TERM, 1956

No. 98

PANHANDLE EASTERN PIPE LINE COMPANY,
*Petitioner,*

VERSUS

CITY OF DETROIT, MICHIGAN AND
COUNTY OF WAYNE, MICHIGAN,
*Respondents.*

**On Petition for Rehearing on Petition for Writ of Certiorari to the Court of Appeals for the District of Columbia Circuit**

## BRIEF AMICUS CURIAE OF THE CORPORATION COMMISSION OF THE STATE OF OKLAHOMA

The Corporation Commission of the State of Oklahoma, by its duly authorized Conservation Attorney and by the Attorney General of the State of Oklahoma, files this brief amicus curiae pursuant to Rule 42 of this Court and respectfully requests this Court to grant a rehearing of its order entered October 8, 1956, denying the petition for writ of certiorari herein and that a writ of certiorari issue to review the judgment of the Court of Appeals for the District of Columbia Circuit in the above entitled cause.

## PURPOSE OF THIS BRIEF

It is not the purpose of the Corporation Commission of the State of Oklahoma to champion the cause of any party to this proceedings. This Commission is, however, by the Constitution and Laws of the State of Oklahoma charged with the responsibility of prorating the production of gas and protecting the correlative rights of producers in common reservoirs and as a consequence is vitally interested in the method employed in fixing the rates to be received by gas producers where, as here, it is believed that the rate fixing method required by the decision of the lower court would impair the Commission's ability to discharge its constitutional and statutory duties.

While this case relates only to the method to be used by the Federal Power Commission in determining the rate to be allowed Panhandle Eastern Pipe Line Company for gas produced by that company, it necessarily follows that the same method will be applied in fixing the rates at which gas may be sold by the hundreds of independent producers of natural gas in Oklahoma and elsewhere who were brought within the ambit of Federal regulation by the decision of this Court in *Phillips Petroleum Company* v. *Wisconsin*, 347 U.S. 672, decided June 7, 1954.

By this brief the Corporation Commission of the State of Oklahoma wishes to demonstrate to the Court not only that there is involved herein an important question of Federal law which has not been but should be decided by this Court, namely, the rate-making formula to be applied by the Federal Power Commission in fixing rates at which producers may sell natural gas for resale in interstate com-

merce, but also that unless this question is resolved on the basis of a field price as hereinafter set forth, the legitimate powers of the State of Oklahoma to enforce ratable taking and protect correlative rights in natural gas may be seriously impeded.

## DECISION OF THE COURT BELOW

While the decision of the Court below does not in precise terms require the use of the so-called "original cost" formula by the Federal Power Commission in regulating the price which gas producers may receive for their gas, the plain import of such decision is that the original cost formula is to be used as the basic test and any deviation therefrom to take into account the field price formula (which the Federal Power Commission applied in this case) must be justified by competent evidence demonstrating that the price so fixed *and no more* is required to induce producers to continue further development of natural gas and the marketing thereof in interstate commerce. The decision of the lower court creates a standard of proof which if allowed to stand can result only in utter chaos and confusion among gas producers whose rates are subject to regulation by the Federal Power Commission, gas purchasers and ultimately the consuming public. Gas producers throughout the nation have from the very inception of this case looked upon it as a test case to dispel the confusion which has existed with respect to the manner in which production should be regulated. The decision of the lower court adds to the confusion. This appears to be a case of such national importance that if not now settled by this Court the questions presented therein will continue to arise.

## THE ORIGINAL COST FORMULA AND ITS DESTRUCTIVE EFFECT UPON CORRELATIVE RIGHTS

The State of Oklahoma has enacted comprehensive oil and gas conservation and common purchaser laws pursuant to its undeniable right to prevent economic and physical waste of natural gas and protect the correlative rights of owners of a common source of supply. It is fundamental to our protection of the correlative rights of producers of natural gas in a common source of supply that this Commission allow each separate owner of gas in a common source of supply to take therefrom only his pro rata share thereof, thus assuring the respective owners of their fair share of the total market demand from such common source of supply. It is self-evident that if the original cost formula is used as the basic yardstick for fixing the rates of producers of gas subject to regulation under the Natural Gas Act there will necessarily be as many different prices for gas in a common source of supply as there are owners in each well. Equally fundamental is the fact that the price at which a producer may sell his pro rata share of natural gas is just as important to the protection of his correlative rights as is the volume of gas which he may produce. As a necessary consequence therefore the principle of protection of correlative rights by ratable taking and purchase of production would be utterly destroyed and attempts at enforcing the same meaningless if a cost formula were to be imposed upon such producers. The tool dresser who contibutes his labor, the driller who furnishes the tools and the various lease owners who consolidate their leases for a fractional ownership in the resulting gas well will each have a distinctly different original cost and the price each can charge

for his gas from the same well, will on an original cost basis differ radically. Even wider disparity in gas prices results between different leases in the same common source of supply due only to the difference in time at which the leases were purchased—the lease purchased after the field was proven having a high and the lease purchased before discovery having a very low original cost. This Commission cannot protect the correlative rights of owners in a common source of supply having such diverse original cost, if while allowing each producer to take his ratable share from a well one producer obtains three cents for his share and another nine cents. The correlative rights of producers to produce and market ratably becomes ineffective under diverse rates resulting from the application of the original cost theory to gas production. In *Phillips Petroleum Company* v. *State of Oklahoma*, 340 U.S. 190, this Court recognized the connection between realized price and conservation, saying at page 191:

> "Phillips argues that it is not a purchaser but merely a producer; that unlike the situation in Cities Service, the order as applied to it lacks any connection with correlative rights, the interest of the public, monopolistic practices or discrimination. *The distinction is without a difference: the connection between realized price and conservation applies to all production in the field, whether owners purchase from others or not, and whether they own pipe lines or not.*"

Producers' correlative rights are just as effectively destroyed by diverse pricing in a common source of supply as would be the case if some were denied the right to market their allocated share of the gas. Both the right to equally

produce and the right to equal pricing of such production are inherent in the correlative rights of producers from a common reservoir.

The conservation powers of the State of Oklahoma contemplate not only that gas shall be produced without waste and the correlative rights of owners therein protected, but also that such conservation powers be exercised to encourage and promote the full and efficient development of this great natural resource within the state. The search for further gas supplies within the state is an extremely risky and hazardous business and will be seriously impeded by the adoption of a rate-making formula which gives no consideration to the great risk inherent in drilling for and producing natural gas or results in enforced diverse pricing of gas from the same source of supply.

## THE FIELD PRICE FORMULA

The Corporation Commission of the State of Oklahoma respectfully submits that the field price formula as applied to producers of natural gas subject to regulation under the Natural Gas Act will not only provide the necessary incentive to further explore and develop, as found and determined by the Federal Power Commission in this case, but more importantly from the standpoint of the protection of correlative rights, will provide a relatively stable, equitable and uniform price for gas within each common source of supply, thus permitting a realistic protection of the correlative rights of producers from a common reservoir by not merely permitting equal production of volumes of gas

but permitting equal realization with respect to price per unit of production.

For the reasons hereinbefore set out, we respectfully urge that this Court grant the petition for rehearing of order denying petition for writ of certiorari and upon such reconsideration to reverse the decision of the United States Court of Appeals for the District of Columbia and affirm the decision of the Federal Power Commission.

Respectfully submitted,

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*Attorney General of Oklahoma;*

FLOYD GREEN,
State Capitol Building,
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*Conservation Attorney, Corporation Commission of the State of Oklahoma.*

October, 1956.

MOTION FILED NOV 2 1956

**IN THE**

# Supreme Court of the United States

**OCTOBER TERM, 1956**

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**No. 98**

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PANHANDLE EASTERN PIPE LINE COMPANY,
*Petitioner,*

vs.

CITY OF DETROIT, MICHIGAN, AND
COUNTY OF WAYNE, MICHIGAN,
*Respondents.*

o———o———o

**ON PETITION FOR WRIT OF CERTIORARI TO THE UNITED STATES COURT OF APPEALS FOR THE DISTRICT OF COLUMBIA**

o———o———o

## MOTION FOR LEAVE TO FILE BRIEF AND BRIEF OF NORTHERN NATURAL GAS COMPANY AS AMICUS CURIAE

o———o———o

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# INDEX


| | Page |
|---|---|
| Motion | 1 |
| Brief | 5 |
| I. Interest of Amicus Curiae | 5 |
| II. Argument | 8 |
| III. Conclusion | 13 |


## CITATIONS

Cases:


City of Detroit, Michigan, v. Federal Power Commission, C. A. D. C., 230 F. 2d 810 ..... 5, 9, 11

Federal Power Commission v. Hope Natural Gas Company, 320 U. S. 591 ..... 3, 8, 10

Federal Power Commission v. Natural Gas Pipeline Company, 315 U. S. 575 ..... 3, 8

In the Matter of Davidor & Davidor, F. P. C. Docket No. G-8550, Order issued March 22, 1956 ..... 10

Panhandle Eastern Pipe Line Company v. Federal Power Commission, 324 U. S. 643 ..... 10

Phillips Petroleum Company v. Wisconsin, 347 U. S. 672 ..... 11, 12


Statutes:


Natural Gas Act, 15 U. S. C. §717, *et seq.* ..... 6

IN THE

# Supreme Court of the United States

OCTOBER TERM, 1956

o———o———o

No. 98

o———o———o

PANHANDLE EASTERN PIPE LINE COMPANY,
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vs.

CITY OF DETROIT, MICHIGAN, AND
COUNTY OF WAYNE, MICHIGAN,
*Respondents.*

o———o———o

**ON PETITION FOR WRIT OF CERTIORARI TO THE UNITED STATES COURT OF APPEALS FOR THE DISTRICT OF COLUMBIA**

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## MOTION FOR LEAVE TO FILE BRIEF AS AMICUS CURIAE

Northern Natural Gas Company (Northern) hereby respectfully moves for leave to file a Brief *amicus curiae* in this case. The consent of the attorney for the petitioner has been obtained. The consent of the attorneys for the respondents was requested but refused.

Northern owns and operates an interstate natural gas transmission system extending from the Texas Panhandle, and Hugoton, Kansas gas fields to the Twin Cities of St. Paul and Minneapolis, Minnesota. It sells natural gas di-

rectly to consumers and also to numerous utility distribution companies in the States of Kansas, Nebraska, Iowa, South Dakota and Minnesota who in turn supply the fuel requirements of hundreds of thousands of consumers in such states. Approximately ten (10) per cent, or over 30,000,000,000 cubic feet, of the gas sold by Northern in the year 1955 was produced by its wholly-owned subsidiary, Northern Natural Gas Producing Company. In addition, as of December 31, 1955, such subsidiary company held leasehold rights to over 850,000 acres of land, approximately 675,000 acres of which were undeveloped for gas production. Northern has, therefore, an immediate and substantial interest in this case wherein the Court of Appeals for the District of Columbia has set aside and remanded an order of the Federal Power Commission which allowed Panhandle Eastern Pipe Line Company to recover, in its rates, the commodity value or "fair field price" of company-produced gas. This Court on October 8, 1956, issued its order denying Panhandle's Petition for Writ of Certiorari seeking review of such decision of the Court of Appeals.[1]

Northern is informed, believes and, therefore, alleges that petitioner in this Case No. 98 will seasonably file a petition for rehearing of this Court's order denying certiorari. If Northern is granted leave to file a Brief as *amicus curiae* herein, it intends to set forth controlling matters of fact and law, additional to those submitted by petitioner, as to why said petition for rehearing should be granted and review of the decision of the Court of Appeals undertaken by this Court. Such Brief will be limited solely to the issue of the validity of the com-

1 Said order also denied a petition for writ of certiorari filed by the Federal Power Commission in the same matter.

modity value or "fair field price" method of valuing natural gas, as adopted by the Commission.[2]

The lower Court in this case has held that if the Federal Power Commission permits a pipeline company—in connection with company-produced gas—to recover in its rates anything above the accounting costs of such production (as determined by application of a utility rate base formula), as an incentive or encouragement for further exploration and development of its own gas supply, the Commission must translate such "incentive" or "encouragement" into a specific number of dollars with an accompanying finding that such dollars are no more than are necessary before the resulting rates may be held to be "just and reasonable" (230 F. 2d 810, 818). Such holding effectively binds the Commission to the use of a rate base formula as an initial determination in fixing the allowance in rates for gas producing activities. Petitioner in its petition for writ of certiorari in Case No. 98 has urged that such a restriction on the authority of the Commission is directly contrary to this Court's interpretation of the provisions of the Natural Gas Act, which it obviously is. Since a clear conflict exists between the lower court's decision in this case and the decisions of this Court in *Federal Power Commission vs. Natural Gas Pipeline Company*, 315 U. S. 575, and *Federal Power Commission v. Hope Natural Gas Company*, 320 U. S. 591, it must be assumed that this Court has denied certiorari on the ground that the question raised is not of sufficient public importance to justify review. Northern will show in its Brief as *amicus curiae* that the question presented is of such widespread importance as to *require* review, even in the event that the decision of the

2 This issue is raised in Questions (1) and (1a) in Panhandle's petition for writ of certiorari in Case No. 98.

lower court is ultimately affirmed. If this argument is accepted, it will be dispositive of the issue presently before the Court, to-wit, the petition for rehearing of this Court's order denying certiorari in Case No. 98.

Respectfully submitted,

F. VINSON ROACH, *Counsel for Northern Natural Gas Company.*

IN THE

# Supreme Court of the United States

OCTOBER TERM, 1956

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No. 98

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PANHANDLE EASTERN PIPE LINE COMPANY,
*Petitioner,*

vs.

CITY OF DETROIT, MICHIGAN, AND
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o———o———o

**ON PETITION FOR WRIT OF CERTIORARI TO THE UNITED STATES COURT OF APPEALS FOR THE DISTRICT OF COLUMBIA**

o———o———o

## BRIEF OF NORTHERN NATURAL GAS COMPANY AS AMICUS CURIAE

o———o———o

### I. INTEREST OF AMICUS CURIAE

On October 8, 1956, this Court issued its order herein denying the petition of Panhandle Eastern Pipe Line Company (Petitioner) for a Writ of Certiorari to review the decision of the Court of Appeals for the District of Columbia in *City of Detroit, Michigan, v. Federal Power Commission*, 230 F. 2d 810. Petitioner thereafter

filed an Application for Stay of Issuance of Order Denying Certiorari and stated therein that it will file a petition for rehearing of such order. Northern Natural Gas Company (Northern), as *amicus curiae*, respectfully urges the Court to grant said petition for rehearing and that, upon such rehearing, a Writ of Certiorari issue to the Court of Appeals for the District of Columbia on the question of the commodity value or "fair field price" of natural gas produced by an interstate pipeline company, as set forth in Questions (1) and (1a) of the petition for writ of certiorari in Case No. 98. With respect to such questions, Northern hereby adopts the arguments and authorities heretofore advanced by Petitioner as fully as if such arguments and authorities were set forth in this Brief. This Brief will set forth additional and supplementary reasons why this Court *must* undertake a review, on the merits, of the lower court's decision.

Northern's interest in this case is two-fold. First, since Northern's wholly-owned subsidiary is engaged in the production of natural gas, it has a direct and immediate monetary interest in any method the Federal Power Commission (Commission) may use to value natural gas produced by a pipeline company. Secondly, as a "natural-gas company"[1] subject to regulation by the Commission under the Natural Gas Act (52 Stat. 821 (1938), as amended, 15 U. S. C. §717, *et seq.*), Northern is vitally interested in the feasibility and practicality, as well as legality, of any method of valuation of pipeline-produced gas.

Northern owns and operates an integrated natural gas pipeline system extending from the Texas Panhandle and Hugoton, Kansas, gas fields to the Twin Cities of

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1 52 Stat. 821 (1938), 15 U. S. C. §717a.

Minneapolis and St. Paul, Minnesota. Peoples Natural Gas Division, the retail distribution division of Northern, sells gas directly to approximately 70,000 customers located in the States of Kansas, Nebraska, Iowa, South Dakota and Minnesota. Thirty-three (33) other utility distribution companies and municipalities, serving approximately 750,000 customers, purchase their natural gas requirements from Northern. House heating customers constitute seventy-three per cent (73%) of all consumers on Northern's system.

During the year 1955 Northern sold 303 billion cubic feet of natural gas. Of this amount 31.8 billion cubic feet, or approximately 10%, was produced by Northern's wholly-owned subsidiary, Northern Natural Gas Producing Company. Such subsidiary company, as of December 31, 1955, held leasehold rights to over 850,000 acres of land, approximately 675,000 acres of which were undeveloped for natural gas production. About 36,000 acres of these undeveloped gas leaseholds were considered "proven" for gas production. The remainder of such undeveloped leaseholds may or may not be capable of producing natural gas in commercial quantities, but this can only be determined by the expenditure of many thousands of dollars for exploration and development.

In order for Northern, through its subsidiary, to continue to produce a substantial part of the gas requirements of its customers, it is imperative that the exploration, discovery and development of new gas wells be continued unabated in the future. Further, with respect to approximately 90% of Northern's gas supply, it is imperative that the producers from whom Northern purchases such natural gas have the necessary incentive to constantly develop new acres and reserves. Only in this manner

can Northern be assured that its supply of natural gas will be adequate to meet the future needs of its customers. Rate regulation of producers under the formula announced by the lower court will not provide the necessary incentive to sources of risk or venture capital needed for exploration. Northern has, therefore, a direct and substantial interest in the final disposition of this case.

## II. ARGUMENT

Petitioner Panhandle Eastern Pipe Line Company has clearly established in its Petition for Writ of Certiorari and Briefs filed herein that the decision of the lower court in this case is directly in conflict with decisions of this Court and with the provisions of the Natural Gas Act itself. There can be no doubt that the lower court's decision effectively binds the Commission to the use of a *formula* as a starting point in fixing rates, contrary to this Court's specific holding in *Federal Power Commission v. Natural Gas Pipeline Company*, 315 U. S. 575, 586, and *Federal Power Commission v. Hope Natural Gas Company*, 320 U. S. 591, 602. In such cases this Court held the Commission is not bound to the use of any single formula or combination of formulae determining rates.[2] In view of this, it is assumed by *amicus curiae* that this Court's denial of Panhandle's Petition for Writ of Certiorari was on the ground that the question presented was not of sufficient public importance to justify review. *Amicus curiae* will, therefore, demonstrate that the question of the validity of the use of the "fair field price"

2 Although the lower court adverted to this Court's holding in the **Natural Gas Pipeline** and **Hope** cases, supra, it is apparent that it did not intend to permit any clear departure from the cost rate base method of determining rates. Its statement (230 F. 2d 818) that, "In this case an allowance for the desired purposes, assuming they are valid, could be included without resort to the field price system.", clearly indicates this.

method for pricing natural gas, without restricting the use of such method as was done in this case, is of such primary national importance as to *require* this Court's imprimatur, even if the result on review is an affirmance of the decision of the lower court.

The Commission in this case prescribed increased rates for Panhandle Eastern Pipe Line Company, which rates were found by the Commission to be just and reasonable. As a part of such increase, it permitted Panhandle to recover in its cost of service the commodity value or "fair field price" of the gas it produces, rather than applying a utility rate base formula to such production activities. The Commission did this to provide an "incentive" or "encouragement" to the pipeline company to explore for, discover and produce natural gas since it had found that the public interest is definitely served by a pipeline company producing at least some of the gas it requires, instead of being completely dependent on other producers. The lower court set aside the Commission order, not because the rates resulting from this method of pricing pipeline-produced gas were unjust and unreasonable and not in the public interest, but because the Commission did not receive evidence of and make findings with respect to the *least* number of dollars needed to provide the required incentive.[3] The fallacy of this approach is immediately apparent. "Incentive" and "encouragement" cannot be translated into precise dollars and cents. A specific dollar amount, although adequate to provide the required incentive in one situation, may be totally inadequate in another. "Incentive" and "encouragement" in the natural gas industry, as in any other, are intangibles which carry no price

3 As a matter of fact the court stated it did not consider the rates allowed Panhandle "so high as to be unlawful." 230 F. 2d 810, 818.

tags. It is as unrealistic and illogical to think of "incentive" and "encouragement" in terms of precise dollars and cents as it is to fix rates for natural gas production—a non-utility function—on a utility rate base formula where the return has no rational relationship to the risk of the investment or the value of the product sold. Both of these extreme approaches reflect a supreme reliance on the infallibility of numbers.[4] They are a quest for mathematical certainty in an area where rigidity of formula produces absurd results.[5] This Court has held that, in fixing "just and reasonable" rates the Commission must exercise its expert and informed judgment.[6] In doing so in this case it determined that the public interest required a pipeline company to receive the commodity value or "fair field price" for the natural gas it produces. That exercise of expert and informed judgment has been negated by the decision of the lower court which instead requires slavish adherence, for the sake of an illusory certitude alone, to a mathematical formula discarded by the Commission.

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4 Mr. Justice Jackson, dissenting in the **Hope** case, supra, succinctly expressed this thought when he stated (320 U. S. at p. 643): "However, our quest for certitude is so ardent that we pay an irrational reverence to a technique which uses symbols of certainty, even though experience again and again warns us that they are delusive."

5 The impracticality of attempting to determine rates for gas producers on the rate base method is shown by the Commission statement in its Order, issued March 22, 1956, **In the Matter of Davidor & Davidor,** Docket No. G-8550. In that case the Commission allowed a rate of return of 9%. However, in so doing, it said: "The fact that in this case, a rate of return of 9% will produce a price close to 10c per Mcf [as sought by applicant] may well be nothing more than coincidence. We know that such a rate of return might, in other cases, produce a rate of less than one cent or more than one dollar per Mcf."

6 **Federal Power Commission v. Hope Natural Gas Company,** 320 U. S. 591; **Panhandle Eastern Pipe Line Company v. Federal Power Commission,** 324 U. S. 643.

Requiring the Commission to use the rate base formula, at least as a "point of departure" or "basis of comparison" (230 F. 2d at 818) in determining just and reasonable rates for natural gas production,[7] will have serious and far-reaching effects on the natural gas industry. The decision of the Court of Appeals, coming as it did in the wake of this Court's decision in *Phillips Petroleum Company v. Wisconsin*, 347 U. S. 672, has left the industry and the Commission with no workable plan or method of determining rates for gas production. The absence of any equitable and feasible method of fixing rates will adversely affect the number of new gas wells drilled and produced. The enforced application of a utility rate base formula in the valuation of natural gas production will result in a diminishing gas supply for public consumption.

The decision of the court below, although perhaps affording ultimate consumers of natural gas temporary relief from slightly higher rates, will, over an extended period of time, work to the disadvantage of such consumers. By requiring the Commission to adhere to an impractical and unfeasible formula of determining rates for gas producers, the court is hastening the day when shortage of supply will boost natural gas rates far above the present commodity value or "fair field price" allowed by the Commission in this case. Notwithstanding regulation of gas producers it remains true that, because of the exhaustible and irreplaceable nature of the product involved, the rates paid by ultimate consumers of natural gas are in part the result of the law of supply and de-

7 No distinction is here made between so-called "independent" producers and pipeline companies which produce natural gas. No valid distinction can be made. The Commission's action, in applying the decision of the Court of Appeals herein to independent producer rate cases, confirms this. See note 5, p. 10, supra.

mand. Any method of determining rates for gas producers, therefore, which has the effect of reducing the gas supply, is contrary to the best interests of the ultimate consumers.

From the foregoing it is apparent that the interests of the public, the natural gas industry and the Federal Power Commission all require that this Court undertake a review of the decision of the Court of Appeals for the District of Columbia rendered herein. A definitive ruling by this Court on the freedom of the Commission to use the commodity value or "fair field price" method of pricing pipeline-produced gas—without relation to a utility rate base formula—is the only means now available to dispel the confusion that exists in this area of the law. The harmful effects of the uncertainties and delays engendered by this decision have already been experienced in the natural gas industry. Even an affirmance of the lower court's decision by this Court is to be preferred over the situation presently existing, for at least this Court would have considered the problem on the merits. The welfare of our national economy would seem to dictate that one of the largest industries in the United States, which supplies over twenty-five per cent ((25%) of the nation's fuel requirements, ought to be given a clear mandate as to what method of rate regulation it must proceed under. The unsettled rate problems of the past year, arising by reason of the lower court's decision herein—coupled with this Court's decision in the *Phillips* case, *supra*,—have stifled growth and progress. A review of such decision by this Court will be of invaluable benefit to the continued growth and progress of the natural gas industry and the ultimate consumers of natural gas.

## III. CONCLUSION

For all the reasons hereinbefore set forth, it is respectfully urged that the Petition for Rehearing of Order Denying Certiorari, filed herein by Panhandle Eastern Pipe Line Company, should be granted, and that, upon such rehearing, a Writ of Certiorari issue to the United States Court of Appeals for the District of Columbia.

Respectfully submitted,

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MOTION FILED

FILED
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In the

# SUPREME COURT OF THE UNITED STATES

OCTOBER TERM, 1956

## No. 98

PANHANDLE EASTERN PIPE LINE COMPANY,
*Petitioner,*

VERSUS

CITY OF DETROIT, MICHIGAN AND
COUNTY OF WAYNE, MICHIGAN,
*Respondents.*

**On Petition for Rehearing on Petition for a Writ of Certiorari to the United States Court of Appeals for the District of Columbia Circuit**

## MOTION FOR LEAVE TO FILE BRIEF AMICI CURIAE AND BRIEF AMICI CURIAE

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# INDEX


PAGE

Motion for Leave to File Brief Amici Curiae ..... 1

Brief Amici Curiae of Cities Service Gas Company and Cities Service Gas Producing Company in Support of Petition for Rehearing ..... 5

I. Introduction ..... 5

II. The Importance of This Case to the Public, the Gas Producing Industry and the Pipeline Industry 7

Conclusion ..... 9


## CITATIONS


CASES:

El Paso Natural Gas Company, In the Matter of, (Docket No. G-1618, F.P.C. Opinion, No. 278, issued November 26, 1954) ..... 7

Maryland v. Baltimore Radio Show, 338 U.S. 912 ..... 9

Phillips Petroleum Company v. Wisconsin, 347 U.S. 672 ..... 7

United States v. Carver, 260 U.S. 482 ..... 9

RULES AND REGULATIONS:

Rules of the Federal Power Commission, 18 C.F.R. 154 et seq. ..... 6

In the
Supreme Court of the United States
OCTOBER TERM, 1956

No. 98

PANHANDLE EASTERN PIPE LINE COMPANY,
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VERSUS

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COUNTY OF WAYNE, MICHIGAN,
*Respondents.*

**On Petition for Rehearing on Petition for a Writ of Certiorari to the United States Court of Appeals for the District of Columbia Circuit**

## MOTION FOR LEAVE TO FILE BRIEF AMICI CURIAE

*To the Honorable, The Chief Justice and the Associate Justices of the Supreme Court of the United States:*

Cities Service Gas Company (Gas Company) and Cities Service Gas Producing Company (Producing Company) respectfully move this Court, pursuant to Rule 42 of the Rules of this Court, for leave to file the accompanying brief in this case as *Amici Curiae.*

Movants have been unable to secure the consent of the respondents to the filing of the attached brief. Consent of the petitioner has been obtained.

Cities Service Gas Company is a natural-gas company within the meaning of the Natural Gas Act. It operates an interstate pipeline extending from Texas to western Missouri. It sells gas to distributors for resale to the public, and also sells gas directly to industries located along its pipeline.

Cities Service Gas Producing Company is a wholly-owned subsidiary of the Gas Company. Its business consists principally in the production of natural gas in certain fields in Texas and Oklahoma and the sale thereof at the wellhead to the Gas Company for resale.

Movants respectfully submit that the issues involved in the instant case are of vital importance to them, to the natural-gas pipeline and producing industries, and to the public which they serve. The decision below has caused confusion and uncertainty not only in the natural-gas industry, but in the Federal Power Commission as well. An end to such confusion and uncertainty is of the utmost importance. As is more fully set forth in the accompanying brief, this case presents important questions of Federal law which have not, but should be, passed upon by this Court.

These movants are vitally interested in the issues herein. They consider review by this Court of extreme importance to the public and the natural-gas industry.

The operations of Panhandle, while similar to those of movants, are sufficiently different so that movants believe

the facts regarding their operation should be before this Court in connection with the Court's consideration of Panhandle's Petition for Rehearing of Order Denying Petition for Writ of Certiorari.

Respectfully submitted,

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In the
Supreme Court of the United States
OCTOBER TERM, 1956

No. 98

PANHANDLE EASTERN PIPE LINE COMPANY,
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VERSUS

CITY OF DETROIT, MICHIGAN AND
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*Respondents.*

**On Petition for Rehearing on Petition for a Writ of Certiorari to the United States Court of Appeals for the District of Columbia Circuit**

# BRIEF AMICI CURIAE OF CITIES SERVICE GAS COMPANY AND CITIES SERVICE GAS PRODUCING COMPANY IN SUPPORT OF PETITION FOR REHEARING

## I.

## INTRODUCTION

Cities Service Gas Company (Gas Company) is a natural-gas company within the meaning of the Natural Gas Act. It operates a pipeline system extending from Texas through the States of Oklahoma, Kansas, southern Nebraska and western Missouri. It sells natural gas to distributors

for resale to the public, and also sells gas directly to industries located along its pipeline.

Cities Service Gas Producing Company (Producing Company) is a wholly-owned subsidiary of the Gas Company. It is an "independent producer" of gas as that term is defined by Section 154.91 of the Rules of the Federal Power Commission (18 C.F.R. 154 *et seq.*). Its business consists principally of the production of natural gas in certain fields in Texas and Oklahoma and the sale thereof at the wellhead to the Gas Company for resale in interstate commerce.

After gas has been received into the Gas Company's system, certain hydrocarbons are extracted therefrom. All extraction activities are performed by Cities Service Oil Company, an affiliate of the Gas Company. A minor part of this extraction is performed at two drip control plants located in the gas fields for the purpose of rendering the gas more readily marketable and transportable. The major portion of the extraction is performed at two plants located at Wichita, Kansas, and Blackwell, Oklahoma. These latter two plants extract the liquefiable hydrocarbons of natural gasoline, butane and propane, which extraction is not necessary to render the gas more marketable or transportable. Gas Company receives substantial revenues from Cities Service Oil Company for the gas used in the extraction process.

As will be shown below, these *Amici Curiae* have a substantial interest in the outcome of this case.

## II.

## THE IMPORTANCE OF THIS CASE TO THE PUBLIC, THE GAS PRODUCING INDUSTRY AND THE PIPELINE INDUSTRY

We respectfully submit that this is the type of case which, under Rule 19, should be reviewed by this Court. This is the first case to come before the courts since the enactment of the Natural Gas Act, in which the Federal Power Commission departed from the rate-base method, in fixing the value, at the wellhead, of gas produced by a pipeline company. This is also the first case to come before the courts, since the enactment of the Natural Gas Act, in which the Commission did not credit the jurisdictional cost of service with the revenues derived by a pipeline company from the sale of gasoline extracted from the natural-gas stream.

This case assumes major importance, particularly in view of this Court's decision in *Phillips Petroleum Company v. Wisconsin*, 347 U.S. 672 (1954), wherein the Court held that the Commission had rate jurisdiction over independent producers and gatherers of natural gas, theretofore not considered by the Commission to be subject to the Act. If discrimination between the producers of natural gas is to be avoided, the Commission must use the same method for valuing gas at the wellhead, regardless of whether the producer is a pipeline company, an affiliated producer, or an unaffiliated independent producer. Indeed, the Commission has already stated that the same method will be used. *In the Matter of El Paso Natural Gas Company* (Docket No. G-1618, F.P.C. Opinion No. 278, issued November 26, 1954).

These *Amici Curiae* respectfully submit that the decision below was clearly erroneous as regards the issues relating to the price attributed to Panhandle's own-produced gas and the revenues derived from gasoline sales. These errors are pointed out in the petitions for certiorari filed by petitioners herein. We merely wish to point out and emphasize that the conventional rate-base method for valuing gas at the wellhead was discarded by the Commission for the sound and compelling reasons given in its opinion (R. 9742-9772). All but one of those reasons (not pertinent here) was upheld by the court below as being "within the scope of the Act" (Petitioners' App., p. 12a). Having discarded the conventional cost-rate-base method for reasons which the court below found to be appropriate, the court, nevertheless, imposed the wholly-inconsistent requirement that the results under this discarded method must be compared with the results under the newly-approved method, in order to test the reasonableness of the results under the latter method. But, even after such a comparison is made, to what use can it be appropriately put? Such a comparison would only show that the use of the commodity value method—or, indeed, any other non-conventional method—produced prices either higher or lower than would result from the use of the discarded cost-rate-base method. The comparison itself is meaningless, since it does not, and cannot, indicate whether the prices arrived at by the use of the commodity value method are "just and reasonable." The answer to that question lies in the intrinsic soundness and reasonableness of the commodity value method as a rate-making formula or de-

vice. If the method is reasonable, the prices arrived at by the use of such method are automatically "just and reasonable." Comparing prices arrived at by the use of two appropriate methods is one thing. Comparing prices arrived at by an appropriate method with prices arrived at by a method found to be inappropriate is quite another thing.

The decision of the court below regarding the revenues from the sale of gasoline, we respectfully submit, was clearly erroneous in that it confused "jurisdiction" with "allocation." The decision, in effect, precludes a natural-gas pipeline company from engaging in a related—but separate—business on the same basis as other entities engaged in the identical business.

It is recognized that denial of certiorari by this Court does not indicate approval or disapproval of the decision below. *United States* v. *Carver*, 260 U.S. 482; *Maryland* v. *Baltimore Radio Show*, 338 U.S. 912. The fact remains, however, that the Commission will be required to give effect to the decision of the court below in the scores of cases pending before it, and confusion and doubt will persist in the natural-gas producer and pipeline industry, as well as in the Commission. Such doubt, we respectfully urge, could be dispelled if this Court were to review the decision below.

The foregoing, it is respectfully submitted, clearly indicates that the court below has decided important questions of Federal law which have not been, but should be, settled by this Court. These questions are of major importance to these *Amici Curiae*, as well as the entire nat-

ural-gas industry, the Commission, and the general public. We respectfully urge, therefore, that this Court grant the petition for reheasing of order denying petition for writ of certirorari and upon such reconsideration to reverse the decision of the United States Court of Appeals for the District of Columbia and affirm the decision of the Federal Power Commission.

Respectfully submitted,

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October, 1956.

MOTION FILED NOV 2 1956

IN THE

# Supreme Court of the United States

OCTOBER TERM, 1956

**No. 98.**

PANHANDLE EASTERN PIPE LINE COMPANY,
*Petitioner,*

*vs.*

CITY OF DETROIT, MICHIGAN, AND COUNTY OF WAYNE, MICHIGAN,
*Respondents.*

*ON PETITION FOR REHEARING OF ORDER DENYING PETITION FOR WRIT OF CERTIORARI.*

## MOTION FOR LEAVE TO FILE BRIEF *AMICI CURIAE*, and BRIEF.

COLORADO INTERSTATE GAS COMPANY,
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# TABLE OF CONTENTS.


| | PAGE |
|---|---|
| MOTION OF COLORADO INTERSTATE GAS COMPANY AND OLIN GAS TRANSMISSION CORPORATION FOR LEAVE TO FILE BRIEF, *Amici Curiae* | 1 |
| BRIEF OF COLORADO INTERSTATE GAS COMPANY AND OLIN GAS TRANSMISSION CORPORATION, *Amici Curiae* | 5 |
| I. The decision below has far reaching impact | 6 |
| II. The decision of the Court below transcends the area of judicial concern and impinges upon the area of administrative finality | 8 |
| III. Conclusion | 9 |


## TABLE OF CASES.


| | |
|---|---|
| *Colorado Interstate Gas Company* v. *Federal Power Commission*, 324 U. S. 581 | 8 |
| *Federal Power Commission* v. *Hope Natural Gas Company*, 320 U. S. 591 | 8 |
| *Federal Power Commission* v. *Natural Gas Pipeline Company of America*, 315 U. S. 575 | 9 |
| *New York* v. *United States*, 331 U. S. 284 | 9 |
| *Phillips Petroleum Company* v. *Wisconsin, et al.*, 347 U. S. 672 | 2 |


## STATUTE.


| | |
|---|---|
| Natural Gas Act, 52 Stat. 822 (1938), 15 U. S. C. §717 | 2, 5 |

IN THE

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PANHANDLE EASTERN PIPE LINE COMPANY,
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CITY OF DETROIT, MICHIGAN, and COUNTY OF WAYNE, MICHIGAN,
Respondents.

---

## MOTION OF COLORADO INTERSTATE GAS COMPANY and COLIN GAS TRANSMISSION CORPORATION FOR LEAVE TO FILE BRIEF, *AMICI CURIAE*.

*To the Honorable, the Chief Justice and Associate Justices of the Supreme Court of the United States:*

The above movants respectfully apply for leave to file a brief as *Amici Curiae* in the above entitled case and in support thereof state:

1. The Petitioner has consented to the filing of a brief *Amici Curiae* by these movants. The City of Detroit has refused to give its consent to the filing hereof and the County of Wayne has not responded to counsel's request for such consent.

2. Each of these movants is vitally affected by the decision of the Court below in two very important aspects:

(a) Each is a *producer* of substantial quantities of natural gas which it gathers and transports in interstate commerce for resale under the provisions of the Natural Gas Act, 52 Stat. 822 (1938), 15 U. S. C. §717. In fact, these *Amici*, have cases at the decisional stage before the Federal Power Commission involving the question of pricing their own produced gas.

(b) Each also *purchases* gas from other producers which, since this Court's decision in *Phillips Petroleum Company* v. *Wisconsin, et al.*, 347 U. S. 672, are also subject to the rate provisions of the Act.

3. Thus these movants have the interests of both producer and purchaser and in both capacities they are affected by rates which will be substantially affected by the opinion below. This bifurcated situation is one which must be considered in resolving the problem at hand and probably will not be presented to this Court in the light of a very real problem facing interstate pipeline companies today. That problem is the one of continuing the acquisition of an adequate gas supply to meet ever-growing market demands. Great emphasis is placed upon encouraging the producer-pipeline company to produce its own gas. Even as great emphasis must be placed upon encouragement of the independent producer so that a pipeline company is able to purchase gas supplies. Many companies, like movants, are producer-purchasers. This combination status should be presented here.

4. The area of concern set forth is vitally affected by the opinion below since the Federal Power Commission

order at issue sought to encourage the exploration and development of natural gas. So whether one be a producer or field or pipeline purchaser, future gas supply depends ultimately upon either the pipeline producer or independent producer. The Commission's finding should, therefore, be viewed in the light of the broad and important implications involved.

5. For these reasons movants believe they have a very real and relevant interest in this case insofar as questions "(1)" and "(1a)" as presented in the Petition for Certiorari are concerned.

WHEREFORE, it is respectfully moved that this motion to file a brief *Amici Curiae* be granted and the brief in the form attached be received.

COLORADO INTERSTATE GAS COMPANY
OLIN GAS TRANSMISSION CORPORATION

By JAMES LAWRENCE WHITE
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IN THE

# Supreme Court of the United States

OCTOBER TERM, 1956

**No. 98.**

PANHANDLE EASTERN PIPE LINE COMPANY,
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CITY OF DETROIT, MICHIGAN, AND COUNTY OF WAYNE, MICHIGAN,
Respondents.

*ON PETITION FOR REHEARING OF ORDER DENYING PETITION FOR WRIT OF CERTIORARI.*

## BRIEF OF COLORADO INTERSTATE GAS COMPANY and OLIN GAS TRANSMISSION CORPORATION, *AMICI CURIAE.*

These *Amici Curiae*, with deference, represent to this Court that the denial of a writ of certiorari here has served to create fear and doubt as to the continued supply of adequate quantities of natural gas. The opinion of the Court below, which continues in effect, was one which almost deliberately asks for this Court's review because it directly affects, probably more than any other case under the Natural Gas Act, 52 Stat. 822 (1938), 15 U. S. C. §717, the price a producer is to receive for the risk of seeking gas production. The Court below also appeared to ask for such

review because it impinged upon an area of exclusive regulatory commission concern by prescribing *how*—even *just how*—the Federal Power Commission is to set producer rates.

## I.

### The decision below has far reaching impact.

These *Amici* do not intend to repeat arguments they know will be made. The Petitioner has stated at length the broad effect of the decision below on current or recent cases.*

These *Amici* themselves currently have before the Commission cases in the decisional stages. Olin Gas Transmission Corporation, in the Commission's Docket No. G-8559, has a case which has passed the Trial Examiner stage and will shortly be before the Commission for final decision. Colorado Interstate Gas Company has a case which has reached the final briefing stage before the Commission's Examiner. In each instance the company has claimed a field price for its gas such as the Commission allowed in its order affecting Panhandle.

The Panhandle order of the Commission, however, and consequently the Court of Appeals review of it, have a much broader significance. We are dealing with an industry which today is the sixth largest in the United States in terms of investment and involves service to more than twenty four million consumers. It goes without saying that the natural gas business is an activity which has

* We refer to the petition for rehearing filed on behalf of Panhandle Eastern Pipe Line Company wherein that petitioner details at some length the number of cases currently before the Commission or which have already been decided by the Commission affecting producers.

important national significance. It also goes without saying that the broad service rendered to this whole country cannot be carried on without gas production activity and a future continuation of the exploration for and development of gas producing properties. Production, therefore, is the *sine qua non* of the natural gas industry and those receiving service, or in a position ever to receive service of natural gas, must look to continued production activity. It was the sense of the Commission's decision affecting Panhandle that the broad public interest inherent in encouraging continued production and exploration required an incentive over and above that which would be gained through an allowance upon bare cost rate base approach. The Court below, however, placed such strictures upon the Commission's use of a field price in evaluating the price which a producer must get for his own produced gas that the inevitable effect would be to require, as a beginning point, the old cost rate base approach without regard to the administrative difficulty and indeed impossibility of evaluating the demonstrated public need for a more generous and enlightened allowance.

It goes without saying, therefore, that the decision of the Court below has an impact far and beyond the thrust of this particular case. Rather the decision of the Court below may, and indeed must, affect a major segment of this country's total economy. This fact of itself compels a granting of review of the decision below.

If this Court does not grant certiorari in the instant case it appears that the Commission must do one of two things. Either it will have to give slavish obedience to the opinion of the Court below in the *Panhandle* case in all other producer cases, although such adherence will work against what

the Commission has discerned as the true public interest, or, on the other hand, the Commission must boldly come forth and proclaim that the decision of the Court below is unworkable and again do its level best to grant a rate to producers which comports with the public interest. This Honorable Court should not permit a situation to continue which will work against the public interest or which, on the other hand, will set an administrative tribunal in plain opposition to a judicial tribunal.

## II.

### The decision of the Court below transcends the area of judicial concern and impinges upon the area of administrative finality.

It is clear that the Court below in the case at issue has in effect stated what formula for rate making the Commission must use in fixing rates and charges of a natural gas company. This Honorable Court has upheld the authority of the Commission within its statutory authority to select the basis of rate making without judicial interference. Such determinations of the Commission, so long as they are neither confiscatory nor unreasonably high, shall be affirmed. *Federal Power Commission* v. *Hope Natural Gas Company*, 320 U. S. 591; *Colorado Interstate Gas Company* v. *Federal Power Commission*, 324 U. S. 581. The Court below, however, seeks to relate the Commission's right to use a field price to a bare rate base cost and absent such relation upon the Court's terms it is deemed that the Commission's conclusion as to a proper rate formula is invalid. The clear conclusion is that the Court below has made it mandatory for the Commission to adhere to a rate base

formula "as a basis of comparison" or "as a point of departure". This overlooks the general tenet that the process of rate making is essentially empiric with the process ever fluid and changing. *New York* v. *United States*, 331 U. S. 284, 335. Probably in no other area of the regulatory process has there been a more positive pronouncement by this Court to that end than in cases under the Natural Gas Act. For instance, in the first case under the Natural Gas Act to reach this Court it was held that the Commission was free, within the ambit of its statutory authority, "to make the pragmatic adjustments which may be called for by particular circumstances". *Federal Power Commission* v. *Natural Gas Pipeline Company of America*, 315 U. S. 575, 586. It is apparent that the Court below has impinged upon an area of concern which is exclusively the Commission's. It has done this in a case having far reaching implications and one which can affect the whole natural gas economy of this country. For this reason alone, review is required.

## III.

### Conclusion.

It is apparent that the Court has before it upon this petition for rehearing of denial of certiorari a question of broad public import, a question which will not be resolved by the denial of certiorari but rather one which will grow more troublesome and will undoubtedly result in future litigation and further petitions to the Court for the ultimate resolution which must come.

For all the foregoing reasons the Court should grant the petition for rehearing of its order denying certiorari and

vacate its previous denial thereof and grant certiorari at least as to questions "(1)" and "(1a)" as presented in the original petition of Panhandle Eastern Pipe Line Company.

Respectfully submitted,

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IN THE

# Supreme Court of the United States

OCTOBER TERM, 1956

No. 98

FEDERAL POWER COMMISSION, *Petitioner*

vs.

CITY OF DETROIT, MICHIGAN, AND COUNTY OF WAYNE, MICHIGAN, *Respondent*

**Brief ~~Petition~~ Amicus Curiae of State of Louisiana on ~~Motion~~ Petition for Rehearing on Petition for Writ of Certiorari to the Court of Appeals for the District of Columbia Circuit**

JACK P. F. GREMILLION
*Attorney General*

JOHN B. HUSSEY
*Commissioner of Conservation*

*State Capitol Building,*
*Baton Rouge, Louisiana.*

## SYLLABUS

1. Continuance of supplies of vital energy producing natural resources, such as natural gas, are necessary both for the peacetime economy and national defense of the United States, and any case involving an issue which might endanger the continuance of the supplies of so vital an energy producing natural resource, warrants a full hearing and consideration by the Supreme Court of the United States.

2. Any rate established for an exhaustiable and irreplaceable natural resource which does not consider the necessity of replenishing reserves depleted by normal use, will not assure the continued supplies and reserves of vital energy producing natural resources needed to keep our Nation strong.

3. A net investment rate base formula would not be a feasible nor practical method of regulating producer prices of an exhaustible and irreplaceable natural resources.

4. No rate fixing authority, state or federal, employs a net investment rate base formula for fixing producer price of any energy producing natural resource.

5. Where the State of Michigan does not employ or recognize a net investment rate base formula for fixing producer price of natural gas produced in Michigan, no political subdivision of Michigan should be permitted to use a federal agency to force such a method of fixing producer prices of natural gas produced in other states.

IN THE

# Supreme Court of the United States

OCTOBER TERM, 1956

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No. 98

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FEDERAL POWER COMMISSION, *Petitioner*

vs.

CITY OF DETROIT, MICHIGAN, AND COUNTY OF WAYNE, MICHIGAN, *Respondent*

---

**On ~~Motion~~ Petition for Rehearing on Petition for Writ of Certiorari to the Court of Appeals for the District of Columbia Circuit**

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## BRIEF ~~PETITION~~ Amicus CURIAE OF THE STATE OF LOUISIANA AND THE LOUISIANA CONSERVATION COMMISSIONER

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The State of Louisiana through its Attorney General and the Louisiana Commissioner of Conservation files this brief amicus curiae pursuant to Rule 42, subsection 4 of this Honorable Court and respectfully request this Honorable Court to grant a rehearing of its order entered October 8, 1956 denying the petition

for writ of certiorari herein and that a writ of certiorari herein and that a writ of certiorari issue to review the judgment of the Court of Appeals for the District of Columbia in the above entitled cause.

## STATEMENT OF THE CASE

Panhandle Eastern Pipeline Company is a natural gas pipeline company which transports gas interstate. Its rates for transmission of natural gas are regulated by the Federal Power Commission.

In addition to gas purchased from completely independent sources, Panhandle produces some gas from its own reserves.

The issue involved in this case is what price may be charged by a natural gas transmission company for natural gas produced by it from its own reserves.

Federal Power Commission adopted a "fair field price", permitting the transmission company to value its own gas at the average price received by and paid by it to independent gas producers in the gas fields wherein the transmission company produces gas. The United States Court of Appeals for the District of Columbia Circuit rejected the method applied by The Federal Power Commission in establishing a fair and reasonable price for the gas in that the decision required the use of a rate base method, at least for comparative purposes.

Both Federal Power Commission and Panhandle Eastern Pipeline Company applied to This Honorable Court for writs of certiorari to review that decision

of the Circuit Court of Appeals. The application was denied by This Honorable Court, and Panhandle Eastern has made application to This Honorable Court for a rehearing on its petition for writ of certiorari.

State of Louisiana respectfully submits that any rate or price fixed for production and sale of natural gas which does not recognize the necessity of replenishing reserves and supplies of this vital energy producing natural resource will greatly endanger continuance of reserves and supplies of this vital energy producing natural resource, which is so necessary for national defense and peacetime economy of our Nation.

Such a critical and important national issue certainly warrants a full hearing and consideration by the Highest Court of the Nation.

## ARGUMENT

*May It Please This Honorable Court:*

One of the reasons that the United States is such a great and strong nation is because of the abundance of our supplies and reserves of energy producing natural resources. If we are to keep our nation strong and powerful, we must maintain adequate supplies and reserves of these energy producing natural resources.

Among the energy producing natural resources of our country, are our reserves and supplies of natural gas. Adequate supplies and reserves of natural gas are

vitally necessary for the peacetime economy of our nation as well as for national defense.

Natural gas is not a manufactured commodity, the supply of which can be replenished by manufacturing more. It is not an agricultural commodity which can be grown. Natural gas is an exhaustible and irreplaceable natural resource.

As the presently known reserves of natural gas are depleted by normal use, the only way in which the supplies of this vital energy producing natural resource can be maintained is by the search for and discovery of additional sources and reserves.

If we deplete the presently known reserves of natural gas at a price which includes only the cost of discovery and development of those reserves and makes no provision or incentive for continued search for and discovery of new reserves, we cannot maintain adequate supplies of natural gas. Since the known reserves of natural gas are exhaustible and not replaceable by manufacture, maintenance of adequate reserves requires that the price paid for the energy producing natural resources include an incentive for risk capital to undertake the venture necessary to accomplish a replenishment of those reserves.

Where the supply of a commodity can be replenished by manufacture, a "net investment, rate base" formula may be a practical or applicable method of determining the fair and reasonable price for the commodity. But where the commodity is an exhausti-

ble and irreplaceable natural resource which cannot be increased by manufacture, but can be replaced only by exploration and discovery, any pricing method which does not consider replacement of reserves or replenishment of supplies is not practical, and is a dangerous threat to the strength and security of our Nation.

The instant case involves a fair and reasonable price for natural gas produced from its own reserves by a natural gas transmission company.

It is a healthy situation for a natural gas transmission company to develop and own reserves of its own, in order to insure flexibility of operation in times of peak load and in order to attain bargaining position with respect to volumes and rates of delivery.

If the gas transmission company is to maintain some reserves and supplies of its own, it must secure for the volumes of gas withdrawn from those reserves a price which provides the incentive for replacing or replenishing those reserves. If we use up the reserves which the transmission company now has at the cost of developing those reserves and not consider the need for development of new reserves to replace those thus depleted, then existing supplies will be depleted by normal use and not replaced, and the transmission company will have to go into the open market to replace its own gas reserves.

New reserves cannot be replaced at the cost of present reserves, and it is therefore impracticable to

include cost of discovery of present reserves in cost of service investment rate base of the gas transmission company, if the gas transmission company is to maintain the healthy position of having reserves of its own.

Substantial quantities of natural gas are produced in the State of Michigan. We are reliably informed that no State Agency in the State of Michigan attempts to regulate the field price or producer's price of gas produced in Michigan on a net investment rate base formula. In fixing the price paid by consumers in Michigan for natural gas produced in Michigan, the State of Michigan accepts the contract price established for the gas in the open competitive market.

Nevertheless, the City of Detroit, Michigan, and the County of Wayne, Michigan, are appearing before federal agencies and courts requesting the federal authorities to regulate the producer prices of natural gas produced in other states and sold in Michigan on a basis not recognized in their own state.

Natural gas is now being imported into this country from Canada and importation of gas from Mexico has been authorized. This gas will be transmitted in interstate transmission lines and will compete with gas produced in the United States. The producer price of this gas is not regulated in Mexico or Canada.

The Federal Power Commission certainly has no jurisdiction over producer prices of gas produced in

Canada or in Mexico. It has no jurisdiction over Michigan produced gas consumed in Michigan, New York produced gas consumed in New York, or Illinois produced gas consumed in Illinois. Such gas is committed to the market on a fair and reasonable competitive price.

As a matter of fact, we know of no rate fixing authority in the United States or elsewhere which employs a net investment rate base formula in pricing a natural resource. The obvious reason for this is that it is not feasible nor practical to so value exhaustible and irreplaceable natural resources.

Should the Federal Power Commission be required to regulate gas produced in Louisiana or other States on a basis different from that on which Mexican Canadian produced gas is regulated, or on a basis different from that which the various State rate fixing bodies employ in establishing producer prices for gas produced within their own states, it would certainly be a discrimination against gas produced in Louisiana or other states and transmitted in interstate Commerce.

Many people look upon Louisiana solely as a large producer of gas and neglect to look at the statistics concerning Louisiana's *consumption* of natural gas. Louisiana is the third largest state in the nation in *consumption* of natural gas. During 1954 (which is the latest statistics available to us at this time), Loui-

siana consumed more natural gas than New York, New jersey and Pennsylvania combined. The same year Louisiana consumed more natural gas than Michigan, Wisconsin and Illinois combined.

Louisiana is, therefore, interested in this case not only as the second largest gas producing state in the nation but as the third largest gas *consuming* state in the nation. Louisiana is interested not only in gas supplies for its immediate needs; Louisiana is also interested in assuring a continued supply and adequate reserve of natural gas for its expanding industrial economy.

## CONCLUSION

The State of Louisiana, by its Attorney General and Commissioner of Conservation respectfully request that the Motion for Rehearing on the Petition for Writ of Certiorari to the Court of Appeals for the District of Columbia Circuit be granted and that this matter be given a full hearing and consideration by the Honorable Supreme Court of the United States.

Respectfully submitted,

JACK P. F. GREMILLION
*Attorney General*

JOHN B. HUSSEY
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*Baton Rouge, Louisiana.*

In the

# Supreme Court of the United States

OCTOBER TERM, 1956

No. 98

PANHANDLE EASTERN PIPE LINE COMPANY,
*Petitioner,*

*v.*

CITY OF DETROIT, MICHIGAN, and
COUNTY OF WAYNE, MICHIGAN,
*Respondents.*

## AMICI CURIAE BRIEF OF H. F. SEARS AND A. E. HERRMANN CORPORATION, IN SUPPORT OF PETITION FOR REHEARING OF ORDER DENYING PETITION FOR WRIT OF CERTIORARI.

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## INDEX


| | | Page |
|---|---|---|
| I. | The Interest of the Amici Curiae | 1-2 |
| II. | The Holding of the Court of Appeals Herein Discussed | 2-3 |
| III. | The Holding of the Court of Appeals Is Inconsistent With Former Holdings of This Court | 3-6 |
| IV. | The Method Used by the Commission for Determining the Reasonableness of Rates in the Legislative Sense, as Distinguished From Merely Non-Confiscatory Rates, Is Not for the Courts to Determine | 6-8 |
| V. | The Commission Should Not be Required to Perpetuate Administrative Error | 8-10 |
| VI. | The Use of a Rate-Base Formula to Determine the Value of Gas Where Produced Has Unreasonable and Discriminatory Results | 10-12 |
| Conclusion | | 12 |

Page

Colorado Interstate Gas Co. v. Federal Power Commission, 324 U. S. 581 ..... 5, 9

Federal Power Commission v. Natural Gas Pipeline Company of America, 315 U. S. 575 ..... 4

Hope Natural Gas Co. v. Federal Power Commission, 320 U. S. 591 ..... 4, 7, 9

Phillips Petroleum Co. v. Wisconsin, 347 U. S. 672 ..... 2

Stone v. Farmers Loan & Trust Co., 166 U. S. 307 ..... 3

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## AMICI CURIAE BRIEF OF H. F. SEARS AND A. E. HERRMANN CORPORATION, IN SUPPORT OF PETITION FOR REHEARING OF ORDER DENYING PETITION FOR WRIT OF CERTIORARI.

H. F. SEARS and A. E. HERRMANN CORPORATION respectfully file the following amici curiae brief in support of the pending Petition for Rehearing of Order Denying Petition for Writ of Certiorari in Cause No. 98, on the docket of this Court.

### I.

### THE INTEREST OF THE AMICI CURIAE

The undersigned are independent producers of gas in the Texas Panhandle Gas Field who own no pipeline transportation facilities but do sell gas to owners of such pipe-

line facilities who then transport the gas so purchased to other states for resale for public consumption. Under such circumstances, such independent producers are natural gas companies under the interpretation given the Natural Gas Act by this Court in *Phillips Petroleum Company v. Wisconsin*, *347 U. S. 672*, and their rates are subject to regulation by the Federal Power Commission. They now have pending before an Examiner of the Federal Power Commission proceedings dealing with the reasonableness of contract prices for gas sold by them to an interstate pipeline company, and are now faced by the decision of the Court of Appeals for the District of Columbia Circuit in this case to the effect that the Federal Power Commission under the Natural Gas Act must determine the reasonableness of rates of a natural gas company by comparison with a rate derived through application of a "return on rate-base" formula.[1]

## II.

## THE HOLDING OF THE COURT OF APPEALS HEREIN DISCUSSED

This brief is limited to a discussion of the holding of the Court below that in rate proceedings under the Natural Gas Act the Federal Power Commission *must* determine a reasonable rate by use of the conventional rate-base method

[1]The situation which faces these two producers is typical of that which faces many independent producers now and will continually arise in proceedings before the Federal Power Commission until this Court shall have authoritatively determined whether the Court of Appeals for the District of Columbia Circuit has correctly interpreted the requirements of the Natural Gas Act.

"for the purpose of comparison" with such increased price, or as "a point of departure."

It is respectfully submitted, as will hereinafer be fully pointed out, that there is nothing in the Natural Gas Act to support such holding; and by such holding the Honorable Court of Appeals has invaded the field which by the Natural Gas Act is vested exclusively in the Federal Power Commission.

## III.

## THE HOLDING OF THE COURT OF APPEALS IS INCONSISTENT WITH FORMER HOLDINGS OF THIS COURT

The use of a rate-base method in fixing rates, sometimes referred to as the cost of service method, was designed and heretofore has been used only as a test to determine whether a price fixed by a regulatory body meets the minimal requirements of the Fifth and Fourteenth Amendments,—to provide a floor below which the regulatory body could not go. Under the opinion of the Court below, the formula also provides a ceiling.

The cost of service principle, *as a test of constitutionality*, had its origin in the dissenting opinion of Mr. Justice Field in *Stone v. Farmers Loan & Trust Co. (Railroad Commission Cases), 166 U. S. 307.* He observed that the recognized right of a state to prescribe a maximum rate for transportation "must necessarily be subject to the qualification that the prescribed maximum shall *at least* equal the cost of service." *(116 U. S. at 346.)*

For many years following *Smyth v. Ames, 169 U. S. 466,* members of this Court were in sharp disagreement as to whether, in applying the "cost of service" philosophy as a test of constitutionality, the fair value of the property or the prudent investment herein should be used as the base on which to compute a fair return. But the test was applied only in determining judicially whether a particular rate fixed by the legislative body was confiscatory, not whether rates were fair and reasonable in the legislative sense.

In the first case which came before this Court dealing with the rate provisions of the Natural Gas Act, *Federal Power Commission v. Natural Gas Pipeline Company of America, 315 U. S. 575,* this Court made it clear that the Constitution does not bind rate-making bodies to the service of any single formula or combination of formulas, and that the courts' only function where a fair hearing has been given and statutory requirements complied with is to determine whether the limits of due process have been overstepped. *(315 U. S. at 586.)*

Having held in the *Natural Gas Pipeline Company* case that no formula or combination of formulas was prescribed by the Constitution, this Court went further in *Hope Natural Gas Company v. Federal Power Commission, 320 U. S. 591,* expressly holding that *Congress* had provided no formula by which the "just and reasonable" rate is to be determined; had not filled in the details of the general prescription of Sections 4 and 5 of the Natural Gas Act; and had not expressed in a specific rule the fixed principle of "just and reasonable." *(320 U. S., at 601.)*

In *Colorado Interstate Gas Co. v. Federal Power Commission, 324 U. S. 581*, four members of the Court were of the opinion that because of the exemption of production from the jurisdiction of the Federal Power Commission under the Natural Gas Act, the Commission had no power to fix the value of company-produced gas by use of the rate-base method. However, the majority stated:

> "We do not say that the Commission lacks the authority to depart from the rate-base method. We only hold that the Commission is not precluded from using it." *(324 U. S. 601.)*

Thus, this Court has emphasized, even in cases where confiscation was claimed, that the Natural Gas Act provides no formula necessary for use by the Commission in determining what is a reasonable rate. The holding by the Court of Appeals that the Commission must use a rate-base formula to develop a rate for use as a basis for comparison or as a point of departure is therefore in conflict with principles thus announced by this Court.

The Court of Appeals agreed that the Commission in fixing rates may recognize the necessity that prices of gas should be adequate to encourage exploration and development, but it held that the Commission *must* find that the allowance made is no more than is needed for that purpose. That holding is in conflict with the principles followed by this Court in the cases referred to because it contemplates the use of a rate-base formula with a specific allowance in that formula for the exact amount needed to provide an incentive for exploration. The Commission is straight-jack-

eted by the requirement that it allow no more than needed for a particular company to have that incentive.

## IV.

## THE METHOD USED BY THE COMMISSION FOR DETERMINING THE REASONABLENESS OF RATES IN THE LEGISLATIVE SENSE, AS DISTINGUISHED FROM MERELY NON-CONFISCATORY RATES, IS NOT FOR THE COURTS TO DETERMINE

In the very nature of things the Commission when legislatively determining the reasonableness of rates must look to the future as well as the present. It is its function to adopt such policies as it believes will, in the long run, result in the availability of the greatest quantity of gas to the greatest number of consumers at reasonable prices. Such matters cannot always be measured by a slide rule and mathematically and exactly determined.

The cost of service principle used judicially in determining whether rates of a utility are confiscatory was developed principally because the properties of such utilities, unlike merchandise, are not commonly bought and sold in the market. This necessity does not exist when determining legislatively the fair and reasonable price of gas. Gas is a commodity that is used both within the states where produced and in states to which it is transported. It is used not only for general consumption for heat and fuel purposes, but also for carbon black manufacture and many chemical purposes.

The Commission should be permitted to select the method for determining the price at which gas is sold for interstate transportation in order that interstate markets will be an attractive outlet for gas in competition with intrastate markets for carbon black manufacture, chemical uses and intrastate outlets for heat and fuel purposes. But the method which it uses to achieve that goal is an administrative matter for exclusive determination by the Commission, not one of a judicial nature for determination by the courts.

In *Federal Power Commission v. Hope Natural Gas Co.*, *320 U. S. 591*, two members of the Court considered that the rate-base method is wholly unrealistic for use in an attempt to fix a fair and reasonable price for gas at the place where it is produced; that the Natural Gas Act is not concerned with abstract theories of rate-making but that its foundation is the "public interest"; that this public interest is a texture of multiple strands, including more than contemporary investors and contemporary consumers; and that the needs to be served are not restricted to immediacy but social as well as economic costs should be counted. It was their view that the case should be returned to the Commission so that, if it so desired, the Commission could consider the broad public interest involved; that the Commission might have been constrained by former opinions of the Court to accept the rate-base method of valuation and a particular formula as all important for a rate base.

A majority of the Court, however, were of the opinion that:

> "Apart from the requirements of judicial review, it is not for us to advise the Commission how to dicharge its functions." *(320 U. S. at 617.)*

and pointed out that Congress had not provided a formula by which the "just and reasonable" rate is to be determined and had not expressed in a specific rule the fixed principle of "just and reasonable." *(320 U. S., at 601.)*

This holding in the controlling opinion in that case is equally applicable here. Where no question of confiscation is involved, it is for the exclusive judgment of the Commission how it will arrive at reasonable rates, and it is not a function of the courts to direct the Commission as to how it will reach such determinations.

## V.

## THE COMMISSION SHOULD NOT BE REQUIRED TO PERPETUATE ADMINISTRATIVE ERROR

It was stated by the Court of Appeals that the Commission had repeatedly used the rate-base method for determining the reasonableness of rates, and its action in doing so had been repeatedly approved by the courts; that unless that method be continued to be used at least as a point of departure, the whole experience under the Act is discarded. *(230 F. 2d, at 818-819.)* The Court did not, however, recognize that in the cases referred to the question was as to

whether the rates allowed by the Commission were adequate in the constitutional sense.

But, aside from that distinction, there is no reason why the Commission in the exercise of its legislative functions should be required to perpetuate policy error.

A former member of the Court in his dissenting opinion in *Hope Natural Gas Company v. Federal Power Commission, 320 U. S. 591, 628, et seq.*, and again in *Colorado Interstate Gas Co. v. Federal Power Commission, 324 U. S. 581, 608, et seq.*, demonstrated that any attempt to fix the value of gas by the use of the rate-base method is wholly unrealistic; that gas is tangible, possessable and has a market and a price in the field; that the reason for resort to a roundabout rate-base price fixing does not exist in the case of gas in the field; that the service one renders to society in the gas business is measured by what he gets out of the ground, not by what he puts into it; and there is little more relation between the investment and the results than in a game of poker. He considered that the entire rate-base method should be rejected in pricing gas because of the "delirious" and "fantastic" results obtained from its use.

After this Court rendered its opinion in the *Colorado-Interstate* case, the Commission in Docket G-580 initiated its general gas investigation for the purpose, among other things, of appraising the results of the policies followed by it in the administration of the Natural Gas Act. Hearings were held in that proceeding in various sections of the

nation over a period of several months. When the members of the Commission, as constituted at the time the order here involved was entered, decided, as shown in its opinion accompanying that order, that it was not in the public interest that the price of gas at the point of production be fixed by the use of a rate-base formula, they had the benefit of the evidence adduced in Docket G-580 and the conflicting conclusions therefrom expressed by former members of the Commission, and also their own subsequent observations and experience. They reached the conclusion that policies theretofore followed were not in the public interest. Having reached that conclusion, they had the right to change their policy. The doctrine of *stare decisis* is not applied, even by the courts in deciding legal questions, to perpetuate error. It has *no* place in considering the lawfulness of legislative determinations.

## VI.

## THE USE OF A RATE-BASE FORMULA TO DETERMINE THE VALUE OF GAS WHERE PRODUCED HAS UNREASONABLE AND DISCRIMINATORY RESULTS

The Commission undoubtedly considered that a formula which results in unreasonable differences in prices allowed producers for gas produced in the same area for the same outlets cannot be expected to attract gas to such markets. This difference necessarily arises from the application of *any* rate-base formula. It is illustrated by a comparison of two wells, the production of which is involved in proceed-

ings now pending before the Federal Power Commission above referred to, the Sears Bost Well No. 2 and the Herrmann McLaughlin Well. Both wells are located in the same area, where costs of drilling and producing wells do not differ substantially, the gas is of identical quality, and sales are made to the same purchaser for transportation to the same consuming markets. The economic value of the gas, therefore, is the same to the purchaser and to the ultimate consumers. And yet under the operation of *any* rate-base formula, Sears will be allowed per unit of gas produced from his well *less than one-fourth* the amount allowed Herrmann from its well.

This difference arises from the fact that the producing capacity of the Sears Well is *more than four times* the productivity of the Herrmann Well with the result that Sears produces 37,412 m.c.f. monthly while Herrmann produces only 8,708 m.c.f. monthly. Yet, the "cost of service" would be the same.

The Commission undoubtedly knows of this practical situation; that similar differences in productivity are common to all gas fields and that in many instances the differences are even greater than above illustrated. In the Panhandle Gas Field, productivity of individual wells ranges from only a few hundred thousand cubic feet to more than one hundred million cubic feet daily.

The Commission is not prohibited by the Natural Gas Act from adopting such policies as will make interstate markets an attractive outlet for the production from all

wells, large as well as small. This can be done only by giving effect to the commodity value of gas.

## CONCLUSION

It is respectfully suggested that the holdings of the Court of Appeals have an effect far beyond the interest of the immediate parties; that a broad national interest in the questions decided justifies a consideration by this Court and an authoritative decision as to whether the Court of Appeals has properly interpreted the Natural Gas Act.

Respectfully submitted,

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